

PROCUREMENT CONTRACTING OFFICER'S
GUIDE TO COST ACCOUNTING STANDARDS

Paul O. Soderberg

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THESIS

PROCUREMENT CONTRACTING OFFICER'S GUIDE
TO COST ACCOUNTING STANDARDS

by

Paul O. Soderberg

September 1977

Thesis Advisor:

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A current literature search was conducted to obtain the information contained herein. The reader will not be confronted with technical accounting terms and will need only a basic knowledge of Government procurement to understand the subject matter.

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COST ACCOUNTING STANDARDS

by

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ABSTRACT

This thesis is an exploration of the procurement contracting officer's role in implementing and administering Cost Accounting Standards. It introduces the procurement officer to the subject by discussing the history and development of Cost Accounting Standards, the functions of the Cost Accounting Standards Board, and the methodology utilized by the Department of Defense in implementing Public Law 91-379. The main objective is to define the tasks that Cost Accounting Standards have placed on the procurement officer. By understanding these tasks the procurement officer will better function in the procurement environment.

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I. INTRODUCTION

A significant change impacting upon defense contractor cost accounting systems and the procurement contracting officer's (PCO) traditional role of authority in contracting matters was initiated on August 15, 1970. On this date Congress enacted Public Law 91-379, an amendment to the Defense Production Act of 1950, which established the Cost Accounting Standards Board (CASB). Working as an agent of Congress the CASB has the authority to promulgate cost accounting standards (CAS) through methods described later herein. The implementation of the law within the Department of Defense (DOD) has placed significant emphasis on the audit and administrative functions. The intent of this study is to provide the PCO with the commensurate knowledge of CAS necessary for proper implementation within the DOD procurement arena.

The Defense Contract Audit Agency (DCAA) and the Defense Contract Administration Services (DCAS) are the key DOD agencies involved in CAS administration. However, PCO's have an important role. CAS embraces a highly complex system that mandates coordination not only between the various DOD players, but also among the CASB and defense contractors. Without participation and understanding by all those affected by this relatively new law, its purpose will not be accomplished. Robert K. Mautz, a member of the CAS Board,

stated "Someone has said that we never get any laws that we don't deserve. The cost accounting standards which will be promulgated by the Cost Accounting Standards Board will very likely be as good or as bad as you and other interested parties help us make them."¹ It follows that a strong participatory role of PCO's is essential if the purposes of CAS are to be accomplished.

Although DCAA and DCAS are primarily responsible for implementation and administration of CAS, it must be recognized that the PCO's role is an integral adjunct. The objective of this study is to impart the procurement information attained from a review of current CAS literature upon the reader. Because the Armed Services Procurement Regulations (ASPR) address the PCO's role in CAS in a dispersed fashion, the writer determined that a guide would be advantageous for both interpretation and stating information not present in ASPR. The aim is thus to provide the PCO within DOD the requisite knowledge necessary to aid implementation and coordination of CAS, and to better understand the impact that CAS has had on all parties involved.

The PCO becomes involved in CAS in numerous ways. Some of the decisions directly confronting the PCO include: approval of post-award submission of the disclosure statement

¹Mautz, Robert K., "Living with the Cost Accounting Standards Board," Financial Executive, p. 31, February, 1973.

and pre-award adequacy waiver, determine inclusion of the CAS clauses, participate in negotiation of contract price adjustments, assign contracts for DCAS administration, and process requests for waiver of the CAS clause and disclosure statement. The reader will receive a general understanding of the above PCO responsibilities and CAS terminology so that better communications with all concerned parties will be possible. In pursuit of an over-all guide on cost accounting standards for the PCO, pertinent subjects have been identified by chapter headings.

The following chapter will discuss briefly the history of Public Law 91-379. Specific topics to be addressed will include CAS developments, the function of the CASB, and the necessary formation of DOD bodies to implement promulgations by the Board. The third chapter will introduce all CAS Board promulgations to date. By taking an abbreviated look at the Standards, the CAS Clause and the Disclosure Statement, the diverse composition of the CAS system is better realized. After exposure to the promulgations, the PCO responsibilities under Public Law 91-379 will be explained in Chapter IV. Chapter V will address present day industry and DOD progress in implementing CAS, state some of the adversities of CAS, and finally, summarize the previous chapters. Concentration throughout the study will specifically deal with the PCO functions within the CAS system.

Before proceeding it should be noted that the PCO need not have a diverse background in accounting or economics to

interpret the content herein. This guide is not an attempt to make the PCO an accounting expert in CAS theory. Rather, the goal is to impart to the PCO the procurement side of CAS in layman terminology.

II. HISTORY AND DEVELOPMENT

Prior to 1970, Section XV of the Armed Services Procurement Regulations (ASPR) was the only guide available for establishment of contractor cost accounting. Defense procedures generally involved only a minimum of administrative effort required by government and contractor personnel in addressing accounting system changes. The effectiveness of ASPR guidance was often questioned because of the inherent flexibility of the often used phrase "generally accepted accounting principles." Attempts were made to clarify cost accounting principles in Section XV, but it was not until 1968 that major changes were initiated.

In 1968 the Defense Production Act of 1950, during a periodic review, received testimony to the effect that there was an absence of consistent accounting practices by defense contractors. On April 11, 1968, the House Committee on Banking and Currency heard Admiral Hyman Rickover state that "it was nearly impossible to ascertain the profit on a particular contract, because of the lack of control over definitions of, and shifting treatment of, contract costs."² Admiral Rickover concluded by proposing that it was up to Congress to provide uniform accounting standards for defense contractors.

²Commerce Clearing House, Inc., Cost Accounting Standards Guide, Paragraph 1002 (Extracted from the 1968 Defense Production Act Hearings).

Shortly thereafter, Senator Proxmire successfully offered an amendment on the floor of the Senate. This amendment called for the Comptroller General, in cooperation with the Secretary of Defense and the Bureau of the Budget and in consultation with the accounting profession and defense industries, to undertake a study to determine the feasibility of applying uniform cost accounting standards to be used in all negotiated prime contract and subcontract defense procurements of \$100,000 or more.³ The Comptroller General, after conducting an extensive study, reported his findings and recommendations to Congress on January 19, 1970.

The General Accounting Office report generally concluded that it was feasible to establish and apply cost accounting standards which would achieve a greater degree of "conformity and consistency" in cost accounting than presently existed, but that detailed uniformity of practices was not a feasible objective. In reviewing the conclusions of the aforementioned report, both the House and Senate held hearings which resulted in mixed testimony as to the worth of such standards. One area of grave concern to opponents both in 1970 and today is whether the cost of implementing CAS can be balanced with the benefits derived. Determination was made however, that a definite need for cost accounting standards did exist and on August 15, 1970, President Richard M. Nixon signed Public Law 91-379, an amendment to the Defense Production Act of 1950.

³Ibid.

A. COST ACCOUNTING STANDARDS BOARD (CASB)

Public Law 91-379 created a new agency, the CAS Board, which began its operations in 1971. The CASB has five members, composed of the Comptroller General as chairman, one member each from industry and a federal agency, and two from the accounting profession, one of which must have a background in small business firm accounting problems. The CAS Board is similar to the General Accounting Office in that it is an agent of Congress, independent of the executive departments. The Board is directed by statute to promulgate cost accounting standards having the objective of achieving an increased degree of uniformity in accounting practices, and consistency in accounting treatment of costs by defense contractors. Because the CASB meets only monthly for one or two days, it relies heavily on a fulltime staff of about 25 professionals. Between monthly meetings the Board is kept well informed on CAS research and development proceedings through the distribution of staff papers. Also, prior to Board meetings personal briefings by the staff are conducted when necessary. Before discussing specific functions of the CASB, the definitions of some key CAS terms will be covered.

A misconception often formulated of the CAS Board is that its main objective is to force all defense contractors to conform to the same accounting system. Clarification of this fallacy is seen by a brief explanation of the terms "uniformity" and "consistency". The Board's objective regarding uniformity is to achieve likeness under like or

similar circumstances. Recognition of the various complex and diverse work done by defense contractors necessitates different accounting systems. However, if all concerned contractors share a certain likeness, the Board will strive for establishing a single accounting treatment for use in such situations. Consistency relates to only one accounting entity using compatible cost accounting practices from one time period to another. If a contractor follows the same accounting methods year after year, comparisons between estimates and actuals will be more meaningful in like situations.

Two other terms that directly effect the PCO are allowability and allocability. Briefly, allocability refers to the relationship between a cost and a cost objective, while allowability relates to a procurement agency's acceptance or disallowance of certain costs as determined by reasonableness. Additional understanding can be gained from the following:

Cost Accounting Standards provide for the definition and measurement of costs, the assignment of costs to particular cost accounting periods, and the determination of the bases for the direct and indirect allocation of the total assigned costs to the contracts and other cost objectives of these periods. The use of Cost Accounting Standards has no direct bearing on the allowability of those individual items of cost which are subject to limitations or exclusions set forth in the contract or which are otherwise specified as unallowable by the Government.

The Board recognizes that contract costs are only one of several important factors which should be involved in negotiating contracts. Therefore, the promulgation of Cost Accounting Standards, and the determination of contract costs thereunder, cannot be considered a substitute for effective contract negotiation. It should be emphasized that where Cost Accounting Standards are applicable, they are determinative as to the costs allocable to contracts. It is a contracting agency's prerogative to negotiate the allowability of costs which are allocated to contracts; however, the definition of what is a cost for purposes of negotiated defense contracts and how the amount thereof is⁴ to be allocated is a function of Cost Accounting Standards.

By having a basic knowledge of uniformity and consistency, and by being able to distinguish between allowable and allocable costs, the operations of the CASB may be better realized.

As mentioned previously the basic mandate of the CAS Board is to promulgate cost accounting standards. In promulgating such standards the Board takes into account the probable costs of implementation compared to the probable benefits. Since promulgations by the Board impact upon several parties, any proposed standards must be researched in depth to keep conflict or disagreement at a minimum. Once the CASB determines that a proposed subject is desirable for a possible standard, the staff initiates a research program. This extensive research process includes examining procurement regulations, reviewing pronouncements of authoritative accounting and regulatory groups, study of pertinent court cases, and consultation with various

⁴Cost Accounting Standards Board, "Restatement of Objectives, Policies and Concepts", Federal Contract Reports, No. 681, published by the Bureau of National Affairs, Inc., Washington, D.C., p. F-2, May 17, 1977.

government agencies, government contractors, industry, and the accounting profession. Direct conversation and questionnaires are utilized to get a broad interpretation of the subject. Arthur Schoenhaut, the Executive Secretary of the CASB, stated "we go to great lengths and take great pains to solicit in-put from all organizations--large and small, government and nongovernment."⁵ Either during or at the end of the research effort, the staff can recommend disposing or continuing study of a proposed standard.

If the decision is to continue development, a tentative standard is drafted for the Board's review and further discussion at the staff level. When convinced that the standard is both desirable and necessary, the Board must grant permission for publishing a draft of the proposed standard in the Federal Register. Federal Register exposure allows 30 days for additional comments from interested parties which can result in further revisions to a standard. If revision is not necessary the promulgation must await the expiration of 60 calendar days of continuous session of Congress before it can become effective. Congress can also pass a concurrent resolution stating that it does not favor the proposed standard. Note should be made here that the above policy is also true for other rules and regulations promulgated by the Board.

⁵Schoenhaut, Arthur, "CASB Past, Present, and Future", Financial Executive, p. 32, September, 1973.

After 60 days the CASB's promulgations have the full force and effect of law. Since July 1, 1972, the effective date of the Board's first promulgations, several other accomplishments have been made. To date there have been 15 standards promulgated which are covered in the following chapter. Chapter III will also address other CASB actions including rules concerning CAS clauses and the disclosure statement requirement.

Continual review of any effective standards as well as possible new promulgations is a necessary function of the Board. The CASB is interested in all accounting concepts and invites recommendations on matters concerning contract cost accounting. Currently the Board is researching about 15 additional areas for possible development of new standards. It should be mentioned that the Board can and does amend and rescind certain promulgations when amplification or clarification is deemed necessary.

B. DEPARTMENT OF DEFENSE CAS INVOLVEMENT

The primary medium for establishing CAS guidance within the Defense Department has been ASPR. In 1973, DOD established an ASPR Subcommittee that deals specifically with CASB promulgations. Issued by the then Assistant Secretary of Defense (Installations and Logistics) (ASD(I&L)) this regulation specifically addresses CAS in Section 3-1200 and Appendix O, with Section XV, "Cost Principles," containing subject matter directly related to the functions of the CAS Board. Much of the CAS guidance in ASPR initially

appeared in Defense Procurement Circulars (DPCs), which are used to update and supplement ASPR. Other vehicles which may be used by the military departments for supplementing ASPR and implementing CAS include Navy Procurement Directives, Army Procurement Procedures, and Air Force ASPR Supplements. An index of ASPR CAS subject areas can be found in Appendix A.

In addition to the above methods for disseminating CAS information, DOD determined that there was need for its own central CAS group. Because of the complex nature of the standards, implementation problems and delays in administration of CAS had mounted by 1975. Dr. John J. Bennett, then acting ASD(I&L), stated in a memorandum dated 15 August 1975, that the central CAS group was needed "to formulate administrative procedures, provide guidance directly to field personnel, monitor and evaluate CAS developments, disseminate new information to field personnel, and make field visits to investigate particular issues." This central group is now called the CAS Working Group.

The Working Group consists of a representative from the Office of the Assistant Secretary of Defense (Comptroller), each of the military departments, DCAS, DCAA, and is presently chaired by Mr. C. E. Deardorff from the Office of the Director of Defense Research and Engineering.

The Working Group receives guidance and support from the CAS Steering Committee. The Steering Committee is composed of six members including: the Assistant Secretary of

Defense (Comptroller), the Director of the Defense Logistics Agency, and the Assistant Secretaries (I&L) of the three Military Departments. It was previously chaired by ASD(I&L). It should be noted that because of ongoing reorganization with DOD, the ASD(I&L) title has been eliminated, and the new chairman of the CAS Steering Committee has not been named at the time of this writing. Duties of the Committee include providing liaison between DOD and the CAS Board, responding to Congressional inquiries, and establishing interim guidance for administration of CAS.

Interim guidance is generally published in the memorandum form of Working Group Papers which are drafted by the CAS Working Group for distribution to DOD agencies. Appendix B includes a copy of all Working Group Papers published to date. When appropriate, Working Group Papers can be further published in DPCs, and when determined necessary, the Papers can become a part of ASPR. At the time of this writing 19 Working Group Papers have been published. Although much of the information stated in the Papers relates to administrative functions, some remarks do apply to the PCO. For this reason an index of the papers is given in Appendix B for PCO reference.

In further recognition of the need to confront CAS head-on, DOD has established a CAS training program at the Army Logistics Management Center, Fort Lee, Virginia, in the form of a two-week course designed to educate contracting officers, price analysts, and auditors on the functions of CAS.

The school has recently designed a two to four day CAS orientation course specifically tailored for central procurement and contract administration personnel. Other special training seminars have been conducted periodically by DCAS, DCAA, and the Air Force.

The major changes discussed above testify to the significant impact that the implementation of CAS has had upon the Defense Department. The complexity of CAS and their ramifications mandates a high level of skill for effective implementation. Although administrative problems are still present, diligent training through courses and published changes has proven a valuable aid in increasing the effectiveness of implementing CAS. The rigid requirements that are characteristic of CAS and how they effect the PCO will be addressed in the following chapters.

III. COST ACCOUNTING STANDARDS BOARD PROMULGATIONS

Now that a basic background of the CAS Board and the Defense Department's involvement in implementing the CAS system has been introduced, the effective CASB promulgations to date will be reviewed. In discussing the subject of Board actions three specific areas shall be addressed. The three areas which a procurement officer must be aware of are: (1) cost accounting standards that have been promulgated, (2) the contract clauses that have resulted from CAS, and (3) the disclosure statement. It is important to realize that CAS Board promulgations will only be introduced in this chapter. The following chapter will discuss the rules and regulations for implementing the Board's promulgations and identify the implications that the CAS system has had upon the procurement officer.

It is not the intent of this chapter to discuss all the CASB promulgations in depth. However, to realize the overall complexity of Public Law 91-379 and the ramifications that it has had on the procurement process, a condensed version of the effective standards is necessary. To further aid the reader references for the information contained herein will be identified. This compact exposure should prove valuable as an information base for the following chapter and also, provide a brief introduction to the CAS novice.

The initial promulgations by the CAS Board became effective on July 1, 1972. These first actions became law as stated in the Code of Federal Regulations, Title 4, Accounts. Included in the introductory CAS material were two standards, guidance for contract coverage, the disclosure statement, and a compendium of definitions. Appendix O of ASPR incorporates verbatim all effective promulgations stated in the above source. Contract coverage is stated in Subchapter C, Procurement Practices, Part 331. The disclosure statement is stated in Subchapter E, Part 351. Definitions and the standards are stated in Subchapter G, Cost Accounting Standards, Part 400. DPC Number 76-2, dated August 31, 1976, is the latest update of ASPR, Appendix O.

A. COST ACCOUNTING STANDARDS

Chapter II stated the research methodology that eventually culminates in the promulgation of cost accounting standards. In striving to increase uniformity and consistency as defined previously, the underlying objectives of the CAS Board are to improve understanding and communications between defense procurement agencies and contractors. It is hoped that fulfillment of these goals, through conscientious application of CAS by all concerned parties, will enable procurement agencies to function more effectively. Illustration of improved effectiveness could be detected by witnessing a decrease in the number of disputes, reduced disagreements, and facilitation of equitable adjustment of contract settlements.

Before commenting on the individual standards a definition of a standard is necessary. The Cost Accounting Standards Board defines a CAS as a statement that:

- "enunciates a principle or principles to be followed;
- establishes practices to be applied; or
- specifies criteria to be employed in selecting from alternative principles and practices in estimating, accumulating, and reporting costs of contracts subject to the Board's rules and regulations."⁶

Since the first two standards became effective in the summer of 1972, several other standards have been promulgated. When published, each CAS includes statements concerning its general applicability, purpose, appropriate definitions, fundamental requirements, techniques for application, illustrations, exemptions and the effective date. Only brief remarks about each standard, extracted from Appendix O of ASPR, will be mentioned below.

The first two standards were quite broad in nature. They provided for consistency requirements to be used in connection with certain negotiated defense contracts and subcontracts. As pointed out in the GAO feasibility study, a primary goal of the CAS system is to develop consistency in contractor accounting practices. The first standard (401) addresses consistency in estimating, accumulating and reporting costs. This standard requires that the same

⁶Comptroller General of the United States, Status Report on the Cost Accounting Standards Program-Accomplishments and Problems, (Report to the Congress on August 20, 1976), p. 5.

accounting practices used by a contractor in developing a proposal be utilized in accumulating and reporting costs during contract performance and vice versa. Interpretation number one to Standard 401 was published in DPC Number 76-7 on April 29, 1977. This interpretation clarifies practices used by contractors to estimate the cost of certain direct materials.

Standard 402 requires that contractors use consistency in allocating costs incurred for the same purpose. The second standard assures that costs will be allocated to a contract or final cost objective only once. This standard addresses charging of costs incurred for the same purpose, in like circumstances, as either direct or indirect costs with respect to the final cost objective. Elimination of "dual charging" of direct and indirect costs is the primary goal of the second standard. A clarifying interpretation of Standard 402 regarding treatment of costs incurred in preparing, submitting, and supporting proposals was published in DPC Number 76-2 of 31 August 1976.

Standards 403 and 404 became effective on 1 July 1973. The purpose of standard 403 is to establish criteria for allocation of the expenses of a home office to the segments of the organization. Contractor segments may include two or more divisions or other plants and subdivisions that report directly to a home office. The allocation is based on the beneficial or causal relationship between the expenses and the various receiving segments of a home office. The standard

includes criteria for allocation of home office expense by the following groups: centralized service functions, staff management of certain activities, line management of certain segments, central payments, independent research and development, and bid and proposal costs. Those home office expenses which are not traceable are termed residual and are allocated by means of a representative base. This standard has created some problems involving the allocation of expenses for state and local taxes. Charles A. Dana, then a member of the CASB, stated in 1973 that the Board "should recognize the deficiencies in the methodology it used to develop and promulgate the cost accounting standard for the allocation of state taxes based on income."⁷ Since this time some contractors have challenged Standard 403, but it remains an effective standard.

Standard 404 requires that contractors establish and adhere to policies of tangible asset capitalization. Capitalization is required for major asset acquisitions and improvements that extend an assets life or increase its usefulness. Specific minimum limitations are set for service life and acquisition cost criteria. When the criteria are met, tangible assets must be capitalized.

In 1974 three more standards were promulgated by the CASB. Standard 405 establishes guidelines for the early

⁷Dana, Charles A. "CASB: A Case Study in Methodology," Financial Executive, November, 1973, p. 100.

identification of unallowable costs and the treatment to be accorded such costs. Emphasis here is on costs that are expressly unallowable or mutually agreed to be unallowable, costs which the contracting officer designates to be unallowable, and costs that arise from work not contractually authorized. Contractor records must be sufficient in detail to identify unallowable costs within the cost objectives where the costs were allocated. In establishing the guidance delineated in this standard, contract negotiation, audit, administration and settlement of disputes should be facilitated. Working Group Paper 77-13, dated March 29, 1977, which will be finalized in the near future, will furnish DOD guidance for implementing this CAS.

The purpose of standard 406 is to provide criteria for the selection of the time periods to be used as cost accounting periods for contract cost estimating, accumulating, and reporting. CAS 406 is intended to enhance objectivity, consistency, and verifiability of contractor cost measurement. The contractor must follow consistent practices in selecting a cost accounting period. However, if an expense is identified with a fixed recurring annual period different than the contractor's cost accounting period, the contractor is permitted to use that different period for that specific expense.

The use of standard costs for direct material and direct labor is addressed in CAS 407. Standard costs are to be used in estimating, accumulating, and reporting direct costs.

Standard costs are defined as any cost computed with the use of pre-established measures. The most common measurement standards are labor-cost (labor-rate times labor-time) and material-cost (material-price times material-quantity). These measurement devices are used for accumulating costs for input or output of production units and variances must be considered. Contractor practices for treating such costs must be stated in writing and followed consistently.

Standards 408 and 409 became effective July 1, 1975. Standard number 408 on accounting for costs of compensated personal absence requires that absence from work for certain employer compensated activities be properly assigned to the correct accounting period. As defined in 408 absence includes that caused by illness, vacation, holidays, jury duty and military training. Entitlement to reimbursement for such costs is recognized on an accrual basis at the time when the employer becomes liable for the compensation.

Standard 409 covers depreciation of tangible capital assets. It provides criteria for assigning depreciation costs of tangible capital assets to the correct accounting period and allocating these costs to cost objectives in a consistent manner. Depreciation costs should be a reasonable measure of the service potential of a particular asset. Any consistent method of depreciation may be used that reflects expected consumption of services. Because contractors are tasked under this standard to depreciate capital assets over

their useful life rather than contract life, much disagreement has arisen with 409.

Due to the possible contractor dis-incentive for investing in new capital equipment, Standard 409 received close scrutiny from Congress prior to its effective date. Senator Alan Cranston summarized his feelings by stating, "I do not think the standard should be implemented in such a way as to discourage capital investment by government contractors . . . Therefore, implementation of Standard 409 may well require prompt, temporary measures to meet the legitimate and real needs of contractors for reimbursement of contract costs which are recognized as proper for the government to pay."⁸ The Profit '76 study, conducted under the direction of the Deputy Secretary of Defense, was instituted partly because of the potential adverse cash flow impact of 409⁹. The administration of this standard within DOD has been quite liberal as a result of the aforementioned problems.

In 1976 the CAS Board promulgated four additional standards including 410, 411, 412, and 414. Standard 410

⁸Letter dated June 3, 1975, from Senator Alan Cranston to the Cost Accounting Standards Board Chairman, Elmer Staats, regarding the standard on depreciation of tangible assets, Federal Contracts Reports, No. 587, p. E-1, June 30, 1975.

⁹Profit '76 was a study of the profitability of Defense Contractors by government agencies and industry for reviewing profit and pricing policies for negotiated contracts. DPC Number 76-3 of September 1, 1976, states the significant changes in DOD policy that were a result of the study.

provides criteria for the allocation of the cost of management and administration of business based on beneficial or causal relationship. General and administrative expenses include management, financial, and other expenses incurred to a business unit which are not otherwise measured by another cost base. Use of an allocation base measured by cost input versus cost output is the major change brought on by this standard. Guidance is also given for allocating items produced or worked on for inventory. Standard 410 forces contractors utilizing cost of sales as an allocation base to change to a cost input method and this change has created some problems.

Terence E. McClary, the Defense Department Comptroller and a member of the CASB, made the following remarks prior to the effective date of Standard 410. "The real difficulty faced is how to move from present practices to the proposed requirement that contractors use a cost input base in allocating G & A expenses to Government contracts . . . The contractors who would be required to change their existing cost accounting practices view the proposed Standard 410 as having significantly adverse effect on their financial statements."¹⁰ In realizing the possible conflict for some contractors, DOD has allowed a special transition period for the change from output to input cost base.

¹⁰ McClary, Terence E., Remarks before the American Bar Association National Institute Program prior to the effective date of Standard 410, Federal Contracts Reports, No. 635, p. A-5, June 14, 1976.

Interim guidance for implementing 410 is found in Working Group Paper 77-11, dated February 2, 1977.

The purpose of Standard 411 is to provide criteria for the accounting for acquisition costs of material. It provides that the contractor shall have set written policies for accumulating material costs and allocating those costs to cost objectives. Any of five inventory costing methods may be used, but the chosen one must be used consistently. 411 also provides that the cost of material used solely for performing indirect functions may be allocated to an indirect cost pool when it is not a significant element of production cost.

Standard 412 provides guidance for determining and measuring the components of pension cost. The standard establishes the basis on which pension costs shall be assigned to cost accounting periods. Two types of pension plans are recognized. In the defined-contribution plan the benefits are determined by contributions in advance. The defined-benefit plan allows for benefits to be established in advance with later contributions providing for those benefits. Pension, benefit, and actuarial cost methods can be used to determine prospective employee benefits. Implementing guidance is available in Working Group Paper 76-1, dated 24 February 1976.

The initial Standard 413 on adjustment of historical depreciation costs for inflation was withdrawn by the Board.

However, a new Standard 413 on adjustment and allocation of pension costs has recently been proposed and may become effective by late 1977.

Standard 414 recognizes the cost of money for facilities capital as an allowable element of contract cost. The cost of money calculation involves determining the amount of contractor capital allocable to the contract. This amount is then multiplied by a cost of money rate and the resulting interest cost is assigned to final cost objectives. The process will result in contractors developing facilities capital cost factors for all indirect cost pools. Accumulation and distribution of the net book value of facilities capital is then applied to overhead and general and administrative expense pools. The impact of 414 upon the PCO has been greater than any standard to date because he must now recognize the contractor's level of facilities investment in reaching a pre-negotiation profit objective under the weighted guidelines method.

ASPR references 3-808, 3-1300 and 15-205.50, as published in DPC Number 76-3, specify new DOD policy for determining profit. The new weighted guidelines and Standard 414 were implemented on 1 October 1976. Guidance for the implementation of this DPC was spelled out in a memorandum dated 17 September 1976 from Dale R. Babione, the Deputy Assistant Secretary of Defense (Procurement), addressed for the Assistant Secretaries (Installations and Logistics) of the

Military Departments. Further guidance is contained in Working Group Paper 77-18 of 14 June 1977.

The latest cost accounting standard to date, CAS 415, became effective 1 January 1977. Standard fifteen is applicable to the cost of all deferred compensation except for compensated personal absence and pension plan costs (CASs 408 and 412). Deferred compensation means an award to compensate an employee in a future cost accounting period for services in a prior period. The cost of deferred compensation is the present value of future benefits to be paid.

In addition to the preceding standards the CAS Board continues to research new areas of observed cost accounting problems and review standards already promulgated. Areas where current studies may possibly result in the development of new standards or amplification of existing standards include:

1. "accounting for direct materials not incorporated in contract end items;
2. allocation of manufacturing, engineering and comparable overhead;
3. adjustment and allocation of pension cost (proposed CAS 423);
4. distinguishing between direct and indirect costs;
5. accounting for costs of service centers;
6. accounting for insurance costs;
7. allocation of material related costs;
8. independent research and development and bid and proposal costs;

9. indirect costs of colleges and universities;
10. accounting for contract terminations;
11. accounting for intracompany transfers;
12. cost of money as an element of the cost of operating capital;
13. joint product costing; and
14. terminology project."¹¹

As seen by the standards and the above study areas, the CASB has had a significant impact on the procurement field. Cost accounting standards have provided contractor accounting methods which specifically identify contract costs. These requirements were not previously present in DOD procurement regulations. By understanding the standards and the accounting data derived therefrom, the PCO will be better informed for negotiating CAS covered contracts.

B. COST ACCOUNTING STANDARDS CLAUSES

Besides the cost accounting standards, the CAS Board has promulgated a special clause for implementing the CAS system in certain Defense contracts. The CAS clause is inserted in all negotiated contracts exceeding \$100,000 unless certain exceptions apply. These exceptions (exemptions and waivers) will be addressed in the following chapter. Special solicitation notices have also evolved

¹¹Comptroller General of the United States, Cost Accounting Standards Board-Progress Report to the Congress 1976, (Reported August 16, 1976), pp. 10-11.

from the CAS system. The aim of this section is to provide a fundamental understanding of the CAS clauses and solicitation notices.

The primary clause for implementing CAS is entitled "Cost Accounting Standards" and is located in ASPR 7-104.83(a). The clause was part of the initial Board promulgations and was effective on July 1, 1972. The provisions of the clause must apply to all CAS covered contracts. A condensed version of these provisions taken from the above source require that a contractor shall:

1. disclose his cost accounting practices in writing;
2. consistently follow these disclosed practices on all CAS covered contracts;
3. comply with all standards that are effective on the award date of a contract;
4. agree to an equitable adjustment if the contract cost is effected by changed contractor accounting practices brought about by a standard;
5. negotiate with the contracting officer to determine the terms and conditions under which a change to contractor accounting practices may be made;
6. agree to a contract price or cost allowance adjustment when Government costs are increased due to contractor non-compliance with the CAS system;
7. consider a failure to agree, whether the contractor has complied with the CAS system or a cost adjustment demanded by the Government, as a contract dispute concerning question of fact;
8. permit authorized representatives access to records related to CAS system compliance; and
9. include the CAS clause in applicable subcontracts and agree to contract adjustment upon failure of a subcontractor to comply with the CAS system.

The term CAS system used above includes the CAS clause, disclosure statement requirements, standards, and rules and regulations published by the Board. Note that the fourth statement refers to mandatory changes in a contractor's accounting practices which are caused by a standard. Statement six alludes to voluntary changes in a contractor's accounting system. This second type of change will be made at no increased cost to the Government.

Another clause, the administration of cost accounting standards, is found in ASPR 7-104.83(b). This clause is required in all contracts containing the CAS clause. The purpose of the administration of CAS clause is to provide a format for contractors to follow when changes in cost accounting practices necessitate a possible contract price adjustment. The cognizant ACO, with DCAA assistance, is responsible for negotiating any contract price adjustments that arise from the CAS system.

Even though the CAS clause has a provision for collecting interest on increased costs resulting from CAS adjustments, some agencies recommend contract inclusion of the interest clause found in ASPR 7-104.39. The provisions of this clause provide for possible interest charges against a contractor. Interest will be assessed on amounts that a contractor owes the Government if such amounts are not paid within 30 days. Contractor payback situations can occur under CAS when a contractor has not complied with disclosed practices or

effective standards. This clause amplifies the intent of interest payments as defined in paragraph 5 of the CAS clause.

Solicitation notices related to CAS are contained in ASPR 7-2003.67(a), (b) and (c). The first Notice, Disclosure Statement-Cost Accounting Practices and Certification, provides contractor guidance for filing the disclosure statement. Paragraph (b) exempts certain contracts that are equal to or less than \$500,000 from the requirements of the CAS clause. Paragraph (c) is a provision for contractors who have existing CAS contracts. If the contractor's accounting practices must be changed upon award of the proposed contract in order to comply with a standard, the contractor must check yes in the notice. After award of the contract the PCO must notify the ACO of the contractor's response to this provision. More information on the first two notices will be covered in Chapter IV. In conclusion of this section, the PCO is responsible for including the above notices and clauses in applicable solicitations and contracts.

C. DISCLOSURE STATEMENT

In addition to the standards and the CAS clauses the CASB developed a form which discloses the accounting system utilized by certain designated defense contractors and sub-contractors. This form is entitled the disclosure statement and has a different format depending on the type contractor filing. Form CASB-DS-1 is used by commercial contractors

and Form CASB-DS-2 is used by colleges and universities. Disclosure statement (DS) requirements and copies of the two forms are found in Appendix O of ASPR.

The DS was established by Public Law 91-379 to provide a means whereby a contractor's cost accounting system could be described. Specifically, the DS defines a contractor's direct cost of Government contracts, discloses the methods used to distinguish direct cost from indirect costs, and states the method of allocating indirect costs. Once a contractor's practices are disclosed, these same practices must be followed consistently in preparing contract proposals and during contract performance.

In 1972, the CASB provided that information in DSs would not be made public in any case where the contractor requests that it be treated as privileged or confidential. However, the CASB does publish aggregate DS information in its annual reports to Congress. Responses contained in DSs have been collected in a computerized data bank which has proven a valuable source in CASB research. The primary use of DS data, however, is for negotiating, auditing, and administration of contracts. Both contractor and DOD personnel have expressed favorable comments regarding the usefulness of the DS in this respect.

Circumstances warranting post-award submission and waiver of the DS, together with applicable monetary thresholds will be discussed in Chapter IV. The adequacy determination regarding a DS is an ACO function--and-- a

contractor's DS must be submitted to the cognizant ACO and determined adequate before a contract may be awarded.

Final note should be made that the allowability of particular items of cost is not determined by the practices found in a DS. In determining the allowability of costs under a contract, each instance must be considered separately. The allowability of costs is the PCO's responsibility. Inference is made here that the authority of the PCO is in no way abolished by the material presented in a contractor's disclosure statement.

IV. PROCUREMENT OFFICER RESPONSIBILITIES UNDER PUBLIC LAW 91-379

The procurement officer, or a duly authorized representative, is the sole Government agent having exclusive authority to enter into contractual relationships. In the normal DOD procurement cycle the PCO is generally responsible for determining the method of contracting, soliciting procurement sources, negotiations, and award of contract. The administration of defense contracts is most often an ACO function, with the PCO usually making final settlements under the terms and conditions of the contract. DCAS and DCAA are primarily involved in CAS administrative actions and the expertise of these administrative agencies is a key element in the successful implementation of Public Law 91-379.

The procurement officer must rely heavily on recommendations from the ACO when making CAS decisions. Because of this reliance it is imperative that the CAS interactions between the two parties be understood. The goal of this chapter is to identify the PCO's CAS responsibilities. Through clear understanding of the CAS procurement function, the interrelationship between purchasing and administration of CAS should be enhanced.

The importance of the procurement officer is readily seen by reviewing his CAS responsibilities. The chapter subheadings which follow delineate the major PCO functions. As in the preceding chapter, the more important references

are given for reader edification. A chronological procurement cycle order will be followed in the presentation of topics.

A. DISCLOSURE STATEMENT EXEMPTIONS

The initial PCO responsibility regarding the disclosure statement (DS) is concerned with the solicitation notice. Determination must be made by the procuring agency whether to include the notice entitled Disclosure Statement-Cost Accounting Practices and Certification (ASPR 7-2003.67(a)) in the solicitation. PCO guidance for including the DS notice is stated in ASPR 3-1203(a). Presently, if the proposed contract value is less than \$100,000, the notice need not be inserted. If the proposed contract amount exceeds this threshold and the exceptions stated in the above source do not apply, then the notice shall be included in the solicitation.

Not all contractors have to disclose their practices just because of the solicitation notice. The CASB has provided provisions exempting certain contractors from this requirement. The certificate of monetary exemption provides that contractors receiving less than \$10,000,000 net awards on negotiated National Defense prime and subcontracts subject to CAS for fiscal year 1976 or in any subsequent years need not submit a DS. The dollar threshold applies to the cumulative total net awards of all divisions, subsidiaries, and other segments of a single contractor.

It should be noted that if a contractor required to submit a DS has a subdivision whose costs exceed \$100,000 in a proposed contract, that subdivision is required to submit its own DS. Thus, some companies may have to submit more than one DS if the situation so warrants.

Besides the dollar threshold exemption, contractors may qualify for an interim exemption. In this instance the contractor receiving net awards exceeding the dollar threshold the previous year has until March 31 of the year following to submit a completed DS. This exemption applies only to proposals submitted prior to the stated date. The contractor must still comply with the other CAS Clause provisions even though he is exempt from the DS requirement.

If the contractor cannot certify either of the above two exemptions, disclosure of practices is required. The contractor must then certify that he is concurrently submitting a DS with the proposal or that the DS was previously submitted. In either case the contractor further certifies that the practices used in estimating costs in the proposal conform with the DS. Copies of the DS are sent to the ACO, cognizant auditor, and the CAS Board.

Another method for contractor exemption of DS filing has been used only sparingly by DOD. If the Assistant Secretary (Installations and Logistics) for a Military Department determines that it is impractical to secure the Disclosure Statement(s) in accordance with the clause in

ASPR 7-104.83(a) and 3-1203(e), he may authorize award of such contract without obtaining such Statement(s).¹² This authority cannot be delegated and when used, must be reported to the CAS Board within 30 days.

The primary PCO duty concerning DS exemptions is incorporating the DS notice in a solicitation. The determination of exemption from the requirement to submit a DS is normally a contractor/ACO function and in isolated situations this decision is made at the secretariat level. However, it is the responsibility of the PCO to understand and sometimes convey DS notice interpretation to the contractor.

B. POST AWARD SUBMISSION OF THE DISCLOSURE STATEMENT

In certain situations the PCO can grant authorization for the contractor to submit a DS after contract award. This procedure can only be followed if the PCO has made written determination that such authorization is essential (i) to the national defense, (ii) because of public exigency, or (iii) to avoid undue hardship.¹³ A copy of the determination must be included in the contract file. The maximum time allowed for such authorization shall not exceed 90 days. Post award submission of the subcontractor's Disclosure Statement must be approved by the ACO having cognizance of the prime contractor.¹⁴ Thus, if a contractor

¹²ASPR 3-1203(e).

¹³ASPR 3-1203(d).

¹⁴ASPR 3-1206(d).

or subcontractor is required to submit a DS and has not, and the PCO/ACO has not granted authority for post-award submission, award of the contract can not be made.

C. ADEQUACY OF THE DISCLOSURE STATEMENT

Although the PCO does not determine the adequacy of a contractor's DS, he can waive the pre-award adequacy requirement under certain circumstances. The initial review of the DS is accomplished by the cognizant contract auditor. This review concentrates on whether the DS is current, accurate, and complete. Auditor recommendations are forwarded to the ACO for final review.

The ACO is responsible for determining DS adequacy. Results of the ACO determination are passed-on to the contractor, auditor and PCO. If the DS is declared inadequate, the ACO must identify the deficient areas and request that the contractor correct such deficiencies. In situations where inadequate determinations are made by the ACO, the PCO is not authorized to award the contract to that contractor. However, if necessary to protect the interests of the Government, the PCO may waive the pre-award adequacy requirement. Waivers are generally granted to allow the contractor a transition period in which to correct his deficiencies. In the event of a waiver, a determination shall be made as soon after award as possible.¹⁵

¹⁵ASPR 3-1203(b)

Where a significant period of time has elapsed between proposal submission and negotiations, the PCO is advised to check the status of the contractor's DS with the ACO. When the DS is declared adequate by the ACO, the PCO may award the contract. Policy guidance for withdrawing determination of DS adequacy is stated in Working Group Paper 77-20 of 14 June 1977.

D. COST ACCOUNTING STANDARDS CLAUSE EXEMPTIONS

As discussed in Chapter III, CAS Board promulgations are implemented through the utilization of a contract clause. Since procurement agencies are responsible for incorporating the CAS Clause in all applicable contracts, the PCO must be able to distinguish which contracts are CAS covered. This section will discuss the rules and regulations to be followed by the PCO in determining when to include the CAS Clause in a contract.

When a negotiated defense contract exceeds the \$100,000 threshold, the PCO must determine whether to include the CAS Clauses. In making this determination the PCO has to be aware of several exemptions. By law, the CAS Board has exempted certain classes of contractors from complying with the provisions contained in the CAS Clause. Presently, the clause need not be inserted in a contract when any of the following conditions apply:

(i) the price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or is set by law or regulation;

(ii) catalog or market price exemption is determined to exist even though the award is made on the basis of adequate competition. It is the offeror's responsibility to request and to provide justification for a catalog or market price exemption;

(iii) contracts awarded pursuant to Small Business Restricted Advertising;

(iv) contracts awarded pursuant to Partial Small Business Set-Asides;

(v) contracts awarded pursuant to the authority of Section 8(a) of the Small Business Act;

(vi) contracts awarded pursuant to the Labor Surplus Area Set-Aside Procedure;

(vii) contracts for which the Cost Accounting Standards Board has approved a waiver or exemption pursuant to Paragraph 331.30 of Appendix O; or

(viii) contracts which are executed and performed in their entirety outside the United States, its territories and possessions.¹⁶

The second condition was recently published in DPC Number 76-6 dated January 31, 1977. In reference to condition seven above, further clarification is necessary.

Exemption seven applies to any contract or subcontract of \$500,000 or less, unless it is awarded to a contractor who, on the date of such award, (i) has already received a contract or subcontract in excess of \$500,000 subject to CAS and (ii) has not received notification of final acceptance of all items of work to be delivered on that contract or subcontract and on all other contracts or subcontracts awarded after January 1, 1975, which were subject to the Cost Accounting Standards clause.¹⁷ In order to

¹⁶ASPR 3-1204(a).

¹⁷ASPR Appendix O, Section 331.30(b)(8).

effectively administer this exemption the solicitation notice in ASPR 7-2003.67(b) should be inserted in all solicitations requiring the DS notice.

Interpretation of the above exemption indicates that the PCO must include the clause in a contract where the contractor already has a CAS-covered contract in excess of \$500,000 and notification of final acceptance has not been received. This exemption has greatly expanded the number of CAS Clause exemptions. Further note should be made that the CASB is currently contemplating even broader scope of exemption under the \$500,000 threshold. Under a newly proposed rule all contracts less than this amount would be exempt from CAS Clause coverage, even if the contractor has other contracts greater than the stated amount. The proposed promulgation, when effective, will also exempt Small Business Administration contractors that have contracts totalling less than \$10,000,000 annually.

Subcontract CAS coverage follows the same exemption criteria as prime contracts with one exception. Exemption is also granted to firm-fixed price subcontracts made by a contractor or subcontractor after receiving offers from at least two firms not associated with each other . . . providing (1) the solicitation to all competing firms is identical, (2) price is the only consideration in selecting the subcontractor from among the competing firms solicited,

and (3) the lowest offer received in compliance with the solicitation from among those solicited is accepted.¹⁸

Since the above exemptions mainly apply to negotiated contracts and certain subcontracts, special precautions must be adhered to when the PCO is confronted with contract amendments and modifications. If the initial contract is covered by the CAS Clause the PCO determination for inclusion of the clause in amendments and modifications is already made. Note that if new standards have become effective subsequent to contract award, the modification determination must include the date of the newly effective standard. If the original contract is not CAS covered, some concern may develop. Clarification for such a situation is presented in the following statement:

Any modification or amendment to an uncovered formally advertised contract, even if the amendment is negotiated would not cause the clause to be inserted in the amendment. . . Regarding negotiated contracts, the CAS Board has said that for the time being, negotiated modifications in excess of \$100,000 to contracts exempt at their inception will not be covered. However, the annual extension of existing negotiated contracts and similar contract modifications are not exempt.¹⁹

An excellent source clarifying specific situations involving CAS coverage for amendments and modifications is Working Group Paper 76-2 dated February 24, 1976. In summary of

¹⁸ASPR 7-104.83(a)(e).

¹⁹Lamm, Dave V., "The Administration of Cost Accounting Standards", Doctoral Dissertation in Business Administration, George Washington University, p. 67, February, 1976.

this section it should be noted that the exemptions stated herein also apply to the Administration of Cost Accounting Standards Clause (ASPR 7-104.83(b)).

E. WAIVER OF COST ACCOUNTING STANDARDS, RULES AND REGULATIONS

In some contracting situations a contractor may refuse to accept all or part of the provisions contained in the CAS Clause. When confronted with this dilemma, the PCO does have alternative courses of action depending on the circumstances. Usually the PCO and DOD representatives try to convince the contractor to accept the clause. However, since the contractor is aware that DOD can request a waiver from the Board, this technique has usually failed in the past.

Another alternative available to the PCO is to initiate a waiver request. A waiver is different from an exemption in that it only effects one contractor on a specific procurement action. The CAS Board has an established procedure for contracting agencies to follow in requesting a waiver. If the PCO determines that it is impractical to obtain the materials, supplies or services from any other source, he shall prepare the documentation required by paragraph 331.30(c) of Appendix O of ASPR together with information indicating the date by which a reply is needed to meet the contract placement date.²⁰ Upon receiving such

²⁰ASPR 3-1211.

a request from a procuring agency via the prescribed channels, the CASB may waive all or any part of the CAS rules and regulations.

The number of waiver requests has sharply declined in the past few years. In fiscal year 1976, the Board reviewed only five waiver requests, granting exemption to three foreign contractors. One of the two waivers denied by the Board was a request concerning a Navy subcontract with U.S. Steel on the Trident submarine program. The significance of this waiver request was the intervention of the Joint Committee on Defense Production. Following the intervention, U.S. Steel agreed to accept CAS. Moreover, other firms which had planned to seek similar waivers dropped this course of action and the Cost Accounting Standards Board is now assisting certain of them in integrating the uniform cost standards into their accounting procedures.²¹ These proceedings have made it increasingly difficult to obtain a waiver from the CAS Board and it is likely that DOD will use this course of action only as a last resort. As a result of the above, when a contractor adamantly refuses the CAS system the Defense Department should, with possible CASB assistance, confer with contractor personnel who are responsible for accounting procedures. Appendix C provides one method which the PCO

²¹Cost Accounting Standards Waivers and Compliance, Hearings before the Joint Committee on Defense Production: Report dated January 1, 1976, see Bibliography (AIA p. 167).

may choose to follow in gaining contractor acceptance to the CAS Clause provisions.

If all attempts to gain contractor acceptance fail, the PCO should follow the waiver request procedure stated in ASPR 3-1211 and paragraph 331.30(c) of ASPR Appendix O. Note that the contract cannot be awarded until approval of the request has been granted by the Board or the contractor agrees to conform to the CAS contractual provisions or clause. If the waiver request route is followed, ample time must be allotted in procurement planning to allow adequate processing time. Remember that the CASB only meets once each month and they have final approval authority.

F. ASSIGNMENT OF CONTRACT ADMINISTRATION RESPONSIBILITY

The majority of CAS covered contracts are awarded to contractors having contracts which are administered by DCAS. These contractors generally have cognizant DOD contract administrators located within their facilities. In such situations, the ACO will automatically receive a copy of the contract and other pertinent data from the procuring agency. The ACO cognizant of the facility is responsible for the following CAS duties:

1. determine adequacy of prime contractor's Disclosure Statements;
2. determine whether prime contractor's Disclosure Statements are in compliance with Section XV of ASPR and Cost Accounting Standards;
3. determine contractor compliance with Cost Accounting Standards and Disclosure Statements, if applicable; and

4. negotiate price adjustments and execute supplemental agreements pursuant to the Cost Accounting Standards Clause in ASPR 7-104.83.²²

However, when the procuring activity retains in-house responsibility for administering a contract the ACO would not normally become involved except for the CAS functions stated above. Therefore, "if a contract is CAS covered, the PCO shall forward one copy of the contract to the contract administration office cognizant of the contractor's facility . . . The following notation will be inserted in bold print on the face of the contract: 'FOR COST ACCOUNTING STANDARDS ADMINISTRATION ONLY.'"²³ Also, the PCO shall assure that when a contract containing the CAS Clause is awarded to a contractor whose facility is under cognizance of a non-DOD organization, that a copy of such contract stamped as indicated above is forwarded to the contract administration office of the cognizant agency if the contract is not assigned for field administration.²⁴ The PCO must assure that the cognizant ACO receives all pertinent CAS covered contract information when the procuring activity retains in-house administrative responsibility.

²²ASPR 1-406(c) (lix) through (lxii).

²³ASPR 3-1208(b).

²⁴ASPR 3-1208(c).

G. CONTROVERTED COST CLAUSE

The controverted cost clause, often termed the "savings clause" is an outgrowth of disputes that have evolved from the CAS system. Recalling the CAS Clause provisions discussed in Chapter III reveals that a failure to agree on contract cost/price adjustments arising from CAS shall be considered a contract dispute, which is administratively brought before the Armed Services Board of Contract Appeals (ASBCA). Most CAS disputes have resulted from a basic disagreement between the contractor and the procuring agency concerning whether a contractor's accounting system is in fact in compliance with a given Standard. On some occasions a contractor may consider that he has complied with a new Standard, has incurred increased costs as a result, and thus, is due reimbursement. However, if the Government does not recognize compliance by the contractor at this time, reimbursement will be denied. Thus, contract disputes were an alternative course of action. The savings clause which was first used by the Air Force was developed to alleviate possible disputes of this nature.

Working Group Paper 76-7 of October 1, 1976, defines some terms that the reader should be aware of prior to utilizing a savings clause. As stated therein, the effective date of a new standard is that date "designating the point in time when the pricing of all future CAS covered procurements must reflect the requirements of the newly promulgated standard" . . . , and the applicability

date . . . "marks the beginning of the period when the contractor must actually change the accounting and reporting systems to conform to the new standard." The applicability date is usually the beginning of a contractor's next accounting period after receipt of a CAS covered contract following the effective date of the standard.

In certain situations it is virtually impossible for a contractor to comply with a new standard before the applicability date because of major revisions to his accounting system. In this case, to project the impact of the new standard during negotiations could prove inequitable to either the Government or the contractor. Relief from this predicament is offered by the following guidance which was extracted from Working Group Paper 77-10 of 2 February 1977.

1. The ACO shall establish a specific date for the contractor to make the necessary changes to his estimating, accounting and reporting systems to be in compliance with the standard.

2. Negotiation of new firm fixed-price contracts after the effective date of the standard (but prior to the changes made in 1 above) should be conducted using the accounting practice employed by the contractor prior to the standard. The terms of these contracts should include a provision for price adjustment, retroactive to the applicability date, for any significant cost impact (increase or decrease) resulting from changing the accounting practice to comply with the standard.

3. After the effective date of the standard (but prior to the changes made in 1 above) negotiation of ceilings or target costs and fees or profit for new cost type or flexibly priced contracts should be conducted using the accounting practice employed by the contractor prior to the standard. The contract terms of these contracts should include a provision for a ceiling or target cost adjustment (and adjustment of fee or profit, if appropriate) for any

significant estimated cost impact resulting from changing the accounting practice to comply with the standard. In addition, after the necessary changes to the accounting system are made in accordance with 1 above, these changes must be made retroactive to the applicability date of the standard for costs allocated to these contracts.

4. When appropriate, changes in the contractor's Disclosure Statement to reflect the cost accounting practices required by the standard should also be accomplished by the date established in 1 above.

5. When the above procedures are followed there will be no noncompliance reporting, and equitable adjustments computed as of the applicability date of the standard are in order.

Statements 2 and 3 above refer in part to provisions for contract cost/price adjustments after contract award. These provisions are incorporated into the contract through the use of a controverted cost clause.

Although each situation must be treated on an individual basis, Appendix D contains examples of two controverted cost clauses that have been used in the past. The PCO is usually confronted with using this type clause by either ACO or contractor recommendation. ACO recommendations will generally be made when the proposal is evaluated. Contractors that have previous experience with this type of clause may request the PCO to insert such a clause if the circumstances so warrant. In this case the PCO will be responsible for negotiating the terms of the savings clause including future conditions for price/cost adjustment of the contract.

The negotiation of actual cost/price adjustments resulting from using a controverted cost clause generally falls under ACO responsibility. For this reason they are treated using the same procedures as other CAS contract

price adjustments which are discussed in the next section. Note that it is possible for firm fixed-price contracts to have significant changes in value after the contract has been awarded when the savings clause is utilized and following price adjustments occur. The PCO is directly responsible for negotiating the terms of a savings clause, inserting the clause in the contract, and for prompt preparation of funding documents when requested by the ACO after price adjustments have been negotiated. In summary, the utilization of a savings clause requires an intimate knowledge of CAS and the anticipated usage of such a clause by the PCO must be confirmed by cognizant legal and ACO representatives.

H. CAS NONCOMPLIANCE AND CONTRACT PRICE ADJUSTMENTS

Public Law 91-379 provides that contractors are required to follow their disclosed practices and to comply with Cost Accounting Standards in pricing contract proposals and in accumulating and reporting contract performance cost data. The CAS clause contains the provisions which implement these requirements after contract award. Noncompliance can also occur prior to contract award as discussed below. The term noncompliance as used herein will mean failure of a contractor to follow disclosed practices or failure to comply with applicable Standards.

Contractors are concerned about noncompliance because it can mean paying the Government money with interest or can cause certain contract costs to be disallowed. For this reason CAS noncompliance has been an unpopular issue in the past. Previous problems were caused by inadequate communications between the ACO, PCO and contractor personnel. Sometimes the PCO would negotiate noncompliance cost areas with a contractor and not properly document the price negotiation memorandum (PNM) or notify the ACO of his actions. Later conflict between the ACO and the contractor on the subject cost area often was the result. This section is devoted towards alleviation of such problems through better understanding of noncompliance and price adjustments.

The PCO may first encounter noncompliance during the proposal audit phase of the procurement cycle. As mentioned previously, the adequacy review of the DS is conducted by the cognizant contract auditor. Subsequent to the issuance of the determination of adequacy by the ACO, a more detailed review of the DS is made by the auditor to ascertain whether the disclosed practices are in compliance with Cost Accounting Standards and, for DOD procurements, with Section XV of ASPR.²⁵ The auditors findings are then reported to the ACO for noncompliance determination. Unlike the DS adequacy determination, a noncompliance determination does not preclude the PCO from awarding a contract.

²⁵ASPR 3-1205(c)

Although ASPR does not state that the PCO will become involved in pre-award noncompliance issues, as a practical matter he is sometimes notified of contractor noncompliance by the auditor or ACO. Even though prior to award, non-compliance may still occur. Examples would be where a contractor (1) uses estimating procedures different from those which were disclosed in his DS or (2) discloses practices which deviate from those currently used on other CAS-covered contracts being performed by the contractor. When the PCO is notified of contractor alleged or determined noncompliance prior to contract award, two alternatives are available. First, if the noncompliance is a "clean" case where the costs involved are readily identifiable and agreed to by the ACO and contractor and only the proposed contract is affected, the PCO may find it advisable to negotiate the cost impact prior to awarding the contract. The ACO should be made aware of such action and the PCO must clearly document the PNM regarding the specifics of his negotiations. Clear identification of the subject noncompliance cost must be made to insure that any later questions involving the issue can be resolved.

Since the above technique is not always plausible, a second procedure must be explored. Further PCO guidance on noncompliance cases involving contractor proposals is given by the following:

In some cases the ACO may be advised by DCAA that . . . a particular offeror did not submit a proposal which is consistent with its disclosed or established accounting practices, or with applicable Cost Accounting Standards. Since noncompliance with CAS has no remedy outside a contract containing the CAS clause, this lack of consistency cannot be handled as a contractual noncompliance. The ACO, if he concurs with the audit report, shall make a determination of lack of consistency and shall so advise both the offeror and the PCO. In the event this lack of consistency with CAS cannot be resolved prior to award to the offeror in question, either by voluntary action on the part of the offeror or after negotiations conducted by the ACO, the PCO may conclude price negotiations on the basis of the proposal then extant with no adjustment being made on account of the alleged lack of consistency with CAS; provided, the resulting contract shall reserve the Government's rights with regard to the issues involved. The ACO will be responsible for resolving the noncompliance issues and negotiating any resulting price adjustments.²⁶

In situations where the noncompliance is not resolved prior to contract award, the PCO is usually advised to negotiate the contract in accordance with the contractor's proposal and thoroughly document the PNM regarding his actions to preclude possible future adversities. Where a formal noncompliance determination is made by the ACO, that ACO will be responsible for handling the appropriate price adjustment. If the noncompliance determination is disputed by the contractor, a savings clause or similar contract provision is recommended. Important points for the PCO to remember are that it is not a PCO responsibility to identify the impact of an alleged or determined noncompliance, and any PCO action taken must be recorded in the contract file. The PCO must realize that DCAA only identifies

²⁶U. S. Department of Defense, Defense Procurement Circular Number 76-1, Item X, p. 45, 30 August 1976.

potential or alleged noncompliance in the audit report. Formal noncompliance determination is an ACO function. Thus, if noncompliance questions arise, they should be directed to the cognizant ACO for consideration.

When a formal noncompliance determination is made after contract award, the ACO is responsible for any resulting contract price adjustments. In addition to noncompliance determinations, price adjustments can arise from mandatory or voluntary changes. Definitions of these price adjustment circumstances follow:

1. Noncompliance adjustment. If a contractor fails to comply with an applicable standard or to follow a disclosed practice and such failure results in any increased cost paid by the United States under the contract, then the contractor shall agree to an adjustment, with interest, to the contract price or cost allowance, as appropriate.

2. Mandatory change. If a contractor is required to change its disclosure statement or established cost accounting practices, whether the established practices are covered by a disclosure statement or not, to comply with a newly effective standard, then the contractor shall agree to an equitable adjustment as provided in the "changes clause" of the contract if the change affects contract cost.

3. Other changes, sometimes referred to as voluntary changes. If a change, other than one required to comply with a newly effective standard, is made to a cost accounting practice, the contractor shall negotiate with the contracting officer the terms and conditions under which the change may be made. Either the Government or contractor may propose a change to a practice, but the contract adjustment arising from the change shall not result in increased costs paid by the United States.

If the Government and the contractor fail to agree on whether the contractor has complied with an applicable standard, rule, or regulation of the Board, and on the amount of contract adjustment, such failure is a dispute concerning a question of fact within the meaning of the disputes clause of the contract.²⁷

The above three types of price adjustments are further discussed in the CAS clause, ASPR 7-104.83, paragraphs (a)(4) and (a)(5), and in ASPR 3-1212 through 3-1214.

The cognizant ACO is responsible for obtaining the contractor's cost impact proposal and for the conduct of all negotiations of such adjustments to all Government prime contracts.²⁸ Also, the ACO shall invite purchasing offices to participate in negotiations of adjustments when the price of any of their contracts will be increased or decreased by \$10,000 or more.²⁹ Thus, the ACO must coordinate any significant price adjustments with the PCO.

PCO involvement in contract price adjustments could also occur if contract funding changes are necessary. The PCO is responsible for seeing that appropriate funding documents for increasing or decreasing funds are issued in a timely manner. The request for funding changes from the PCO is initiated by the ACO.

Equitable adjustments are limited to those circumstances when a change in a contractor's cost accounting practices

²⁷Comptroller General of the United States, Status Report on the Cost Accounting Standards Program-Accomplishments and Problems, pp. 5-6, 20 August 1976.

²⁸ASPR 3-1207(a).

²⁹ASPR 3-1207(c).

was required to implement a new standard (mandatory change). The solicitation notice entitled "Additional Cost Accounting Standards Applicable to Existing Contracts," ASPR 7-2003.67(c), must be completed by the contractor prior to award. The PCO shall assure that the contractor's response to the notice is made known to the ACO . . . This may be accomplished by attaching a copy of the response to the copy of the contract provided the ACO.³⁰

The PCO is not a technician or decision maker in CAS administration. However, as can be seen from the preceding information, there are many areas where the PCO has responsibilities. PCO's must become familiar with the mechanics of CAS so that the system will function as designed. Deficient participation by any one party, be it the ACO, auditor, PCO or contractor, will cause multiple problems for the others. Additional guidance on non-compliance and price adjustments can be found in Working Group Papers 76-4, 76-5, 76-6, 76-8, 76-9, 77-10, 77-12 and 77-14 all of which are located in Appendix B. Although most of the information present in the papers is designed for the ACO, it is recommended reading for the PCO who becomes involved in noncompliance or price adjustment issues.

A final note concerning compliance relates to the initial solicitation preparation. The procuring activity

³⁰ASPR 3-1213(a).

cannot design proposal requests which dictate how certain types of costs should be estimated and recorded by the contractor if such guidance is contrary to a contractor's method of cost accounting under CAS. Such negligence would place the contractor in an untenable position of complying with the proposal request but not CAS. The PCO must review the proposal request to insure that any accounting procedures stated therein do not conflict with contractor disclosed practices and consistency requirements under CAS.

V. CURRENT CONSIDERATIONS AND SUMMARY

Prior to summarizing the content of this guide some current impressions of CAS will be mentioned. Hopefully, after a brief exposure to some of the present CAS attitudes, the PCO will better realize the advantages and disadvantages that impact upon Government procurement and industry. As with the passage of any new procurement policy or law, Public Law 91-379 has been reviewed with mixed emotions. Interpretations of just how CAS is to be implemented and administered has not been an easy task. DOD has had to instruct and train hundreds of Government procurement employees in the CAS area, as well as gain the support of industry. The man-hours and dollars invested on endeavors to interpret, organize, and carry out CAS have been immeasurable for both DOD and industry. One area of continual debate is whether these high implementation costs are offset by equal benefits.

In promulgating Standards the CASB is required, by Section 719 of the Defense Production Act of 1950, as amended by Public Law 94-152, to take into account "the probable cost of implementation, including inflationary effects, if any, compared to the probable benefits, including advantages and improvements in the pricing, administration, and settlement of contracts."³¹ The CASB views costs and

³¹Cost Accounting Standards Board, "Restatement of Objectives, Policies and Concepts", Federal Contract Reports, No. 681, published by the Bureau of National Affairs, Inc., Washington, D.C., p. F-1, May 16, 1977.

benefits in a broad sense. In general terms, costs are all disruptions of contractors' and agencies' practices and procedures whereas, benefits include anticipated reduction in controversies, greater equity to all concerned, and simplification of negotiation, administration, audit and settlement procedures through the availability of better cost data. These definitions should be kept in mind while reading the following current considerations.

A. CURRENT CONSIDERATIONS

The contention of the Aerospace Industries Association of America (AIA), probably the largest segment of industry affected by CAS, is that "the costs of CAS are being tolerated because of illusory benefits." These companies in voicing their opinion to members of the House and Senate Committees on Banking, Finance and Urban Affairs, Armed Services, Appropriations and Government Operations stated that AIA studies show:

- forecasted Government cost savings have failed to materialize, and the Government and the public are bearing the burden of substantial additional costs as to (a) Government CAS-related operations and (b) the prices paid for products and services because CAS costs incurred by contractors must be covered in such prices.
- new delays and difficulties, including increased disagreements and disputes, have been introduced into the contract negotiation, award, and administrative process.

- CAS requirements have reduced competition for Government contracts and subcontracts because some suppliers are refusing to seek or accept new Government business because of Government requirements including complying with CAS.³²

The above letter report went on to urge Congress to conduct an independent evaluation of CAS and, until that action is accomplished, defer the effective date of any new or additional Standards.

Similar points were raised in a survey conducted by the Council of Defense and Space Industry Associations (CODSIA). This survey report, published in the fall of 1976, concluded that "the objectives which the Cost Accounting Standards were designed to achieve are not being realized, and the Cost Accounting Standards program has resulted in considerable contract administration effort without compensating benefits to the Government." This conclusion was based upon the following:

- a large preponderance of the respondents, who are substantially involved in the Cost Accounting Standards program, in rating each of the benefits claimed, have expressed the opinion that the claimed benefits will not be achieved.
- a preponderance of the respondents stated that the level of effort in proposing and negotiating new business has increased, that costs to the Government have increased and that there has been no increased visibility of costs.

³²Aerospace Industries Association of America, Inc., letter to members of the House and Senate Committees on Banking, Finance and Urban Affairs, Armed Services, Appropriations and Government Operations, dated February 1, 1977.

- there has been a shift in costs between Government and non-Government work as a result of CASB promulgations; however, this shift is small in relation to the overall volume of sales.
- a substantial amount of contract audit and contract administrative effort must have been expended by both Government and industry representatives in identifying, conducting cost impact studies, and negotiating the effect of voluntary accounting changes, and noncompliance issues. Most of the cases were concluded without financial impact.
- for the 120 respondents to this survey, the administrative efforts required were estimated at \$56 million since inception of the Cost Accounting Standards Board.³³

From the preceding industry attitudes towards CAS, one would expect that some major changes in the program are in order. However, consideration of other reports might dispel such a notion. The CASB is required to submit an annual progress report to Congress. In calendar year 1975, thirteen DOD and other Government agencies submitted annual reports required by ASPR 3-1210 to the CASB. The general evaluation of CASB promulgations as reported by these agencies is summarized below:

1. Contractor Proposals-Several agencies reported that improvement in the quality of contractor proposals continues to be observed in the areas of consistency, uniformity, and reliability.

2. Cost Estimate-A number of agencies reported greater visibility of cost and pricing data.

3. Contract Negotiation-Three agencies reported that the negotiation period was shortened and negotiations improved.

³³Council of Defense and Space Industry Associations, "Report-Second Industry Survey-Economic Impact of Cost Accounting Standards," p. 6, Fall 1976.

4. Contract Administration-Several agencies reported that there was an increase in contract administration time and effort.

5. Audits of Contracts-The Defense Contract Audit Agency reported that CASB promulgations (a) assist in resolving many significant long-term accounting and estimating problems, (b) narrow the accounting options and issues among auditors, contractors, and procurement personnel, (c) reduce the number of voluntary changes to contractor accounting practices, (d) cause contractors to discuss changes in accounting practices with Government personnel to resolve disagreements before implementation, (e) result in more consistently prepared proposal packages, (f) enhance the usefulness of historical records in proposal evaluation, and (g) assist in identifying and eliminating unallowable costs.³⁴

Remarks consistent with the above were made by the Office of Federal Procurement Policy (OFPP).

Robert Trimble, OFPP Assistant Administrator for Contract Administration, delivered the following comments on the Standards.

Among the advantages he cited were: some improvement and better visibility in contractor proposal submissions without significant increased effort in the preparation of proposals; better correlation between estimates and recorded costs with better traceability; and facilitating contract negotiations and stabilizing contractor accounting practices . . . He cited as disadvantages: the level of detail and complexity of some Standards have caused problems of implementation; the large amount of time, estimated at 12-15 percent, that DCAS and DCAA spend on monitoring and auditing CAS practices leaves less time for other significant administrative tasks; and CAS is costly both to the Government and industry although it is difficult to establish a cost-benefit relationship.³⁵

³⁴Comptroller General of the United States, Cost Accounting Standards Board-Progress Report to the Congress 1976, (Reported August 16, 1976), p. 12.

³⁵"ABA Panel offers overview of Practical, Legal Implications of CASB Concept for Procurement." Federal Contract Reports, Number 635, p. A-8, June 14, 1976.

After reading the above information on various Government and industry opinions on CAS, a definite divergence in feelings is recognized.

To help "clear the air" a concluding remark on current CAS status is best made by Alan E. Peterson, partner, Government Contracts Division, Arthur Anderson and Company. Long a supporter of the CASB concept and aims from its inception, Peterson continues to believe that significant benefits can accrue to the Government and its contractors if Standards are based on proper economic facts and if proper Standards are developed with the long-term view of improving Government contract costing . . . He warned, however, that the major disadvantages of the Standards can occur from "the development of arbitrary rules, unwise extensions of contract coverage, improper administration by Government representatives, and the lack of a constructive attitude" on the part of both industry and the Government toward developing sound Standards for negotiated contracts .. It is important from an analytical viewpoint, to understand that the Standards for negotiated Government contracts are new so "the jury on the quality of Cost Accounting Standards is still 'out' . . . It is noteworthy, however, that the drafted Standards are far better than anything I saw the ASPR Committee and earlier 'developers' of cost principles achieve after the late 1950's".³⁶

³⁶"ABA Panel offers overview of Practical, Legal Implications of CASB Concept for Procurement," Federal Contract Reports, Number 635, p. A-7 and 7, June 14, 1976.

In analyzing the foregoing remarks, an aura of mixed feelings is clearly denoted. The intent of this discussion was to give the PCO a brief update on some current attitudes towards CAS. It must be realized that CAS has gone through its developmental stages during what has been an erratic economic period. Changing past cost accounting procedures during this period has added cause for concern. Also, adaptation to any change, however minute, is not an easy process in a tradition-oriented procurement environment. It is this writer's view that as both contractor and Government personnel have become more involved in CAS, the implementation process has been enhanced. Thus, since it is highly unlikely that CAS will be terminated, it is incumbent upon all cognizant parties to become involved in properly implementing, administering and complying with Public Law 91-379.

B. SUMMARY

The objective of this study was to provide the PCO with a guide on CAS. In order to provide a background base for the reader and to clearly identify the PCO's role under CAS, a brief exposure to the historical developments of the law was necessary. Since its inception, the CASB has promulgated fifteen Standards, together with other rules and regulations. The implementation and administration of these promulgations within the Defense Department has been a complicated task. Although the establishment of the CAS Steering Committee, Working Group, and ASPR Subcommittee has proven to be most

beneficial in providing guidance and assisting in the implementation of CAS within DOD, direction for the PCO has not specifically been addressed. Hopefully, this study has provided some useful guidance for the PCO to better function in the CAS area.

Even though DCAA and DCAS play significant roles in implementing and administering CAS, the PCO does play an integral part. Communications between the audit, administration and purchasing functions have always been important and have been enhanced by CAS. Chapter IV specifically addressed all areas of CAS which are pertinent to the PCO. The PCO must pursue active involvement in these areas, recognizing that CAS is not totally an ACO function.

Prior to contract award the PCO is responsible for including the appropriate notices and CAS clauses in the solicitation. The PCO must also contact the ACO and assure that the proposed contractor has an adequate DS because this is a precondition for contracting with the Government. The contractor may be exempt from filing a DS or post award submission may be authorized by the PCO after he has made a written determination. Also, the pre-award adequacy determination may be waived by the PCO in certain situations. Close liaison on these matters between the PCO and ACO is essential.

The "tools" for implementing CAS in contracts are the CAS clauses. By law, certain classes of contractors are

exempt from complying with provisions of these clauses. The PCO must be familiar with these exemptions and know when the CAS clauses must be applied to later contract amendments and modifications. When a contractor refuses to accept the provisions of the CAS clauses, a waiver request may be in order. However, a more likely course of action would be for the PCO and DOD representatives to try and convince the contractor to accept the clauses. Assistance from the CASB may even be required but, not until other remedies have been exhausted. The PCO must also insure that for those CAS covered contracts administered in-house, the cognizant ACO receives a copy of the contract.

Close PCO/ACO interface is further required in usage of the controverted cost clause. Usually controverted cost clauses are used to allow for contractual provisions when a contractor cannot comply with a new standard or has a pending dispute. The negotiation of cost or price adjustments resulting from using this type clause is an ACO function. Thus, even though the PCO is responsible for inserting a controverted cost clause in a contract, close liaison with cognizant administrative personnel and legal authority is necessary.

Noncompliance and price adjustment issues was the final area addressed under PCO responsibilities. Pre-award non-compliance may sometimes be negotiated by the PCO but, only after the cognizant auditor and ACO are aware of such action and the PNM is clearly documented. In most

instances, the ACO will negotiate noncompliance price adjustments. Price adjustments occurring after contract award may arise from either noncompliance, mandatory changes to the contractor's accounting system, or voluntary changes that the contractor has made by his own volition. The PCO is responsible for issuing related funding documents in a timely manner and will be invited to participate in the negotiations when the affect on the contract is in excess of \$10,000.

Note the realignment of the PCO's negotiating authority that has occurred regarding CAS contract price adjustments. Previously, the PCO had full responsibility for all aspects of his contract, especially fair and reasonable price for products or services. Now, that responsibility is shared with the ACO. Under CAS the PCO is bound by ACO decisions made on price adjustments, contractor accounting practices agreed to by the contractor and ACO, and determinations of adequacy and compliance.

CAS has had an impact on certain PCO contractual responsibilities. However, the PCO can realize his key position in the effective administration of CAS by the content herein. The PCO does not need to have a diverse accounting and economic background to understand CAS. He must only recognize his role in implementing and administering this complex and dynamic new law.

APPENDIX A

COST ACCOUNTING STANDARDS ARMED SERVICES PROCUREMENT REGULATIONS INDEX

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APPENDIX B

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SUBJECT: Interim Guidance for Implementing CAS 412

Background

Cost Accounting Standard 412--Composition and Measurement of Pension Cost was promulgated on 24 September 1975 (Federal Register, Vol. 40, No. 186). The effective date of the Standard was 1 January 1976.

Beginning with the Standard's effective date, all effort on new contracts that is projected to occur after this Standard becomes applicable must be estimated in conformance with its provisions. (Though the requirement for pricing begins with the effective date, actual compliance in regard to contract costing is required after the beginning of the next cost accounting period following the receipt of a contract to which this Standard applies.) For example, Contractor A, whose accounting period begins 1 July 1976, is awarded a CAS-covered contract on 1 May 1976. The proposal for the contract was submitted 15 January 1976. According to the provisions of CAS 412, Contractor A will be required to comply at the beginning of its next fiscal year (1 July 1976). Since the proposal was submitted after the effective date, the effort projected to occur after the applicability date (1 July 1976) must be estimated in conformance with CAS 412.

Discussion

Under Section 412.50(b)(2) of this Standard, a contractor using an aggregate cost method to measure pension cost is required to make an alternative calculation to ascertain the funding status of the pension plan. The intent of this provision is to reduce the pension cost determined by the aggregate method for any excess funding disclosed by the alternative calculation. Where appropriate, this adjustment should be reflected in estimating the cost of contract effort scheduled to be performed after the Standard becomes applicable.

It appears likely that a substantial number of affected contractors will be unable to make the required alternate computation prior to the period when the standard will be applicable. Thus, proposals submitted may not reflect proper pension costs. This condition could cause the issuance of an inordinate number of noncompliance reports and, to a large extent, impede the negotiation process. Where such conditions occur, this guidance outlines a course

of action for contracting officers to follow which will minimize the need for issuing noncompliance reports and facilitate the pricing and the negotiation of contracts while adequately protecting the Government's interest.

Guidance

When companies using an aggregate actuarial cost method demonstrate, to the satisfaction of the ACO, the inability to make the alternate computation (CAS 412.50(b)(2)) as required by the standard, the following guidance should be followed.

1. The ACO shall establish a specific date for the contractor to furnish the alternate computation required by Standard (412.50(b)(2)).
2. Contract negotiations should be conducted using the actuarial cost method currently employed by the contractor.
3. Contract terms should include a provision for a price adjustment for any significant cost impact resulting from the alternate computation required by the Standard. If a substantial overpayment results, interest should be assessed at a rate prescribed by the provisions of Public Law 91-379.

Interim Guidance for Administration of Cost Accounting
Standards (CAS)

SUBJECT: Application of CAS to Contract Modifications and
to Orders Placed Under Basic Agreements

Background

Questions arise from time to time on how and when CAS is to be applied to changes negotiated on existing contracts. There have also been questions on when CAS should be applicable to Basic agreements and to the orders placed pursuant to such agreements (ASPR 3-410.1 and 3-410.2). In the case of contract modifications the question often comes up when an advertised contract is modified requiring negotiation of a price adjustment which involves costs above the \$100,000 or \$500,000 CAS threshold. Similar questions arise when a negotiated contract not subject to CAS is modified and the pricing action involves amounts that exceed the threshold for CAS application.

In the case of Basic agreements under which orders are placed from time to time, as is the case with Basic ordering agreements, the question is whether CAS should be applied only to orders which exceed the CAS threshold or whether the sum of all orders should be considered. If the latter policy is followed CAS would apply to all orders regardless of individual dollar amount if their sum exceeded the threshold for CAS.

Guidance

With respect to contract modifications the general rule is that any modifications made to a contract pursuant to the terms and conditions of the contract will not affect the status of the contract with respect to CAS application. That is, if CAS was applicable to the original contract, it will be applicable to the modifications, if CAS was not applicable to the original contract, it will not apply to the modification.

Notwithstanding the apparent simplicity of this concept, there are many cases when it may be difficult to decide if CAS is applicable. The following examples are furnished to provide guidance for types of cases that have come to the attention of the CAS Working Group and Steering Committee.

1. The contract was advertised and not subject to CAS, but it contains an option for additional quantities that would exceed the threshold for applying CAS.

a. At a fixed price

b. At a price not to exceed 125% of initial quantity

In the case of "a", there should be no doubt that the option quantity would not be subject to CAS, because it was part of the original advertised solicitation and award was made in accordance with the rules of advertising. In the case of "b", there may be a question since an element of negotiation appears to be involved in establishing the final price. Nevertheless, a firm ceiling price was established and was considered at the time of the initial contract award. CAS would not apply.

If at the time the option is exercised, a decision is made to increase the quantity beyond the amount provided for in the option clause, and if the price negotiated for this portion of the increase exceeds the CAS threshold, CAS will apply to that portion. This increment was not contemplated under the terms of the original contract and must therefore be treated as if it were a new negotiated contract.

2. The contract was negotiated and called for a quantity that was priced below the threshold for CAS (\$100,000 or \$500,000 as the case may be). The contract includes an option that, added to the initial requirement, would exceed the CAS threshold.

This contract was subject to CAS at the outset because it contemplates a total requirement in excess of the CAS threshold.

In the case of Basic Agreements, 3-410 specifically states that they are not contracts (3-410.1(a)). The same statement appears in 3-410.2(a)(1) with respect to basic ordering agreements. All documents falling within the definitions of these two agreements are only to be used to establish certain terms and conditions under which contracts may be placed.

The individual contracts or orders are therefore to be individually considered when determining the applicability of CAS. If the CAS dollar threshold is reached and the negotiated contract or order is not otherwise exempt under the CAS rules and Regulations the contract or order is subject to CAS.

SUBJECT: Interim Policy for Application of Cost Accounting Standards (CAS) to Subcontracts

References:

- a. Cost Accounting Standards (CAS) Clause
- b. ASPR 7-104.83(a), paragraph (a)(3) and (d)

Background

Paragraph (a)(3) of the CAS Clause requires the contractor to "comply with all cost accounting standards in effect on the date of award of this contract . . ." Prime contractors and subcontractors are required by paragraph (d) of the clause to flow its provisions down to lower tier subcontractors.

It is clear that paragraph (a)(3) requires prime contractors to comply with all standards that are effective when the contract is placed. This requirement has also been applied to subcontracts. Recently, however, we have learned that the CAS Board does not construe its rules to require subcontracts to be subject to any standards which are not effective for the prime contract at the time the prime contract is awarded, except to the extent necessary to comply with the second sentence of paragraph (a)(3) of ASPR 7-104.83. ("The contractor shall also comply with any cost accounting standards which hereafter becomes applicable to a contract or subcontract of the contractor.")

Discussion

After careful consideration of the CAS Board interpretation and its impact, we have concluded that, in many cases, the administrative effort to implement this approach could be considerably greater than that required when subcontracts are subject to all standards in effect at the time the subcontracts are placed. This is evident when the two situations are compared. In the one instance, each new subcontract would bring with it all current standards. This would leave no doubt as to the standards applicable to all the contractor's CAS covered work. In the other case, it would be necessary to track back to the prime contract to determine the standards that were effective. Following this, other existing contracts and new awards would have to be reviewed. The results of this would disclose which prime or subcontract included the latest standards, and thus establish the standards applicable to all CAS work.

Admittedly, the problem of identifying standards could be alleviated by requiring the prime contractor and each subcontractor to identify the standards applicable when they place a subcontract. However, this procedure, at best, would still require greater administrative effort than a criterion based on the time of subcontract award.

Guidance

In view of the above, contracting officers should be advised to require their prime contractors to include language in their CAS flow down clause which requires the subcontractors at all tiers to comply with all standards, rules and regulations in effect at the time the subcontract is awarded. In unusual cases, the Head of the Procuring Agency should waive the requirement if, in his judgment, such a waiver is necessary; provided, however, that such waivers cannot relieve the subcontractor from compliance with rules and regulations established by the CAS Board. Thus, the flow down clause must require as a minimum that standards applicable to the prime contract at the time it was awarded shall be applicable to the subcontract and further, that standards applicable to any of the subcontractor's other prime or subcontracts shall also be applicable to the subcontract.

SUBJECT: Determining Increased Costs to the Government
for CAS Covered FFP Contracts - Interim Guidance

Background

Paragraph 4 CFR 331.70(b) of the CAS Rules and Regulations discusses the concept of "increased costs" on firm fixed-price (FFP) contracts as related to noncompliances, i.e., failure to follow disclosed practices or cost accounting standards.

DoD guidance on "Increased Costs Paid Under CAS-Covered Contracts" contained in DPC 75-6 gave an example of increased costs on FFP contracts where there was a non-compliance that resulted in less costs being allocated to the FFP contract than would have been had the appropriate practices been followed.

Discussion

In cases other than noncompliance the opinion has been expressed that no increased cost can occur unless the contract price of a FFP contract is actually increased. This concept cannot adequately protect the Government as was contemplated by PL 91-379, because it provides a situation under which a contractor may overtly or inadvertently adjust accounting procedures so as to cause less costs to be allocated to FFP contracts. The contractor may thus receive a windfall.

To protect the Government in all situations where FFP contracts are involved it is therefore necessary to recognize the phenomenon that occurs when cost allocations are decreased due to accounting changes. The CAS Board did so in 4 CFR 331.70(b). A basic premise of this paragraph is that the amount of such decrease represents the amount of "increased costs to the Government." It is logical that this premise be extended to apply to all cases involving FFP contracts.

Guidance

Increased costs to the Government under firm fixed price contracts should be considered to exist when the costs allocated to the contracts are less than would have been allocated if the method of allocation had not been changed.

SUBJECT: Interim Guidance on Treatment of Implementation
Costs Related to Changes in Cost Accounting
Practices

Background

When a cost accounting practice is changed, whether the change is mandatory (issuance of a new cost accounting standard) or voluntary (any change other than mandatory) costs to implement the change may be incurred. Questions have arisen as to whether implementation costs associated with such practice changes may be included in cost impact statements, and whether such costs should be charged only to CAS covered contracts.

Discussion

Since mandatory changes are required because of CAS Board actions, it has been proposed that total implementation costs should be allocated only to CAS covered contracts. In the case of voluntary changes CAS Board regulations state that there can be no increased cost to the Government. This adds additional significance to the question of whether implementation costs should be included in the cost impact statement. Cost of implementing changes to accounting practices may include the cost of work performed by the contractor's personnel and/or work performed by outside organizations. Such costs are normally included in the contractors' overhead accounts and allocated to appropriate cost objectives.

Guidance

Implementation costs may be included in cost impact statements only to the extent they are a part of appropriate indirect expense pools, and allocated in accordance with the contractor's normal accounting practices. This principle applies to both voluntary changes and changes resulting from the issuance of Standards.

SUBJECT: Interim Guidance on Application of CAS Clauses
to Changes in Contractor's Established Practices
when a Disclosure Statement has been Submitted

Background

Contractors and subcontractors are required to disclose in writing (Disclosure Statement) their cost accounting practices under the criteria set forth in 4 CFR 351.40 and 351.41 of the CAS Rules and Regulations. For those contractors and subcontractors who are not required to submit a disclosure statement their "established cost accounting practices" govern.

ASPR 3-1205 requires the ACO to make a determination as to whether the disclosure statement adequately describes the contractor's cost accounting practices. In order to be deemed adequate, the Disclosure Statement submitted by the contractor must be current, accurate, and complete.

Discussion

A contractor required to submit a Disclosure Statement may have a cost accounting practice which may not be specifically covered by Disclosure Statement Form CASB-DS-1 or there may be other reasons why the practice was not disclosed; therefore, the practice will not be considered a "disclosed practice". When this nondisclosed cost accounting practice is revised due to either a mandatory or voluntary change, the question arises as whether there is a requirement for a revision to the Disclosure Statement and a contract price adjustment. The CAS clause discusses changes to an "established cost accounting practice" as well as a "disclosed cost accounting practice". When a contractor is required to disclose his practices he is, in effect, disclosing his established practices and should be disclosing all relevant cost accounting practices. Therefore, a cost accounting practice not disclosed is considered an "established cost accounting practice" whether or not it should have been disclosed on CASB-DS-1.

Guidance

When an ACO makes a determination that the contractor's Disclosure Statement is adequate it does not necessarily indicate that the ACO is certifying that all cost accounting practices have been disclosed. It does indicate that those

practices disclosed have been adequately described and the ACO currently is not aware of any additional practices that should have been disclosed. Subsequently, when it is discovered that a contractor is not following a cost accounting practice that he failed to disclose or a change to that practice is made the practice will be considered an "established cost accounting practice" and appropriate guidance in ASPR 3-1200 on changes and non-compliances will be followed.

SUBJECT: Interim Guidance on the Significance of "Effective" and "Applicability" Dates Included in Cost Accounting Standards (CAS)

References:

- a. Cost Accounting Standards Clause
- b. ASPR 3-1213

Background

Public Law 91-379 authorizes the Cost Accounting Standards Board (CASB) to promulgate cost accounting standards designed to increase uniformity and consistency in the accounting practices used by defense prime contractors and subcontractors. Companies are required to follow the standards in estimating, accumulating and reporting costs on Government procurements subject to the CASB rules and regulations.

To facilitate the implementation process, each promulgated standard carries its own statement (4 CFR4--.80) regarding the date it becomes effective and generally, a statement describing the time and conditions under which the standard should be applied to the contractor's accounting system--the applicability date.

The effective date designates the point in time the Government can require compliance with the standard's provisions. As a matter of policy, the CASB generally defers the application of the standard to the contractor's accounting system beyond the effective date. This deferral is intended to provide affected contractors adequate time to make necessary preparation for compliance and to provide a more convenient time to initiate the required accounting changes. In this regard, the CASB regulation provides that an effective standard need only be applied after the receipt of the first CAS-covered contract following the effective date. The applicability statement included in most standards extends the date the contractor must actually change his practices to the start of the next cost accounting period following the receipt of the triggering CAS-covered contract.

Since it is apparent that the effective date and the applicability date of a standard generally do not coincide, contracting personnel should be aware of the significance of these dates and understand the appropriate administrative actions required.

Discussion

Effective Date - Subparagraph (a)(3) of the Cost Accounting Standards Clause of ASPR 7-104.83(a) requires compliance with all effective cost accounting standards as of the date of contract award or if the contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the contractor's signed certificate of current cost or pricing data. Therefore, only those CAS-covered contracts in existence on the date a standard becomes effective will be equitably adjusted to reflect the prospective application of the new accounting requirements.

In summary, we can conclude that the effective date of a standard does two important things:

a. Designates the point in time when the pricing of all future CAS-covered procurement must reflect the requirements of the newly promulgated standard, and

b. Identifies those existing contracts eligible for an equitable adjustment to reflect the cost impact of applying, prospectively, the provisions of the new standard.

Applicability Date - This date marks the beginning of the period when the contractor must actually change the accounting and reporting systems to conform to the standard. Up to this point, only the estimates prepared after the standard's effective date had to take into account compliance with the new standard as more fully discussed below. From this point forward, covered contracts must be priced and the cost reported in compliance with all applicable standards.

As indicated earlier, the CASB sets the applicability date beyond the effective date in order to achieve a smooth implementation of the standard. However, special care is needed in considering contractors' proposals submitted for a contract to be awarded after a new standard's effective date but before the standard must be applied.

The proposed effort occurring after the effective date but before the applicability date should be priced using the contractor's old accounting practice. Effort projected to occur on or after the applicability date should be priced in compliance with the new standard.

The equitable adjustment for those CAS-covered contracts in existence when a standard becomes effective should cover the period from the date the standards become applicable through contract completion.

Guidance

Procurement, administration, and audit personnel should carefully review the appropriate section of each newly promulgated standard to identify the effective date and the conditions governing the application of its provisions to actual practices.

A listing of all CAS-covered contracts and subcontracts in existence as of the standard's effective date should be obtained from the contractor. This listing, as confirmed with contract administration records, should represent those contracts eligible for equitable adjustments. ASPR 3-1213 should be followed in administering any equitable adjustments caused by the new standard.

Proposals for contracts to be awarded after the effective date of a standard should be carefully reviewed to ascertain whether it reflects compliance with the standard. The proposal need only reflect compliance with the standard from the applicability date forward.

There will be instances where the impact of the standard cannot reasonably be predicted at the time the proposal is prepared or before the negotiations. Consequently, the effects of applying the standard cannot be reflected in the negotiated price. When this condition occurs procurement officials should make use of contract provisions protecting the Government's interest.

SUBJECT: Interim Guidance on Use of the Offset Principle
in Contract Price Adjustments Resulting from
Accounting Changes

Background

Paragraph (a) (4) (A) of the CAS clause provides for equitable adjustments when accounting system changes result from the issuance of new Cost Accounting Standards. Paragraph (a) (4) (B) of the CAS clause provides that the Contractor will negotiate, with the Contracting Officer, the terms and conditions under which a change to either a disclosed or established cost accounting practice may be made. These changes are generally referred to as "voluntary" changes. The (a) (4) (B) clause goes on to forbid any agreement that will result in increased costs being paid by the United States.

The interpretative language found in 4 CFR 331.70(f) advocates the offsetting approach with regard to voluntary changes whereby price adjustments are foregone to the extent that increases under one or more CAS-covered contracts are equaled or exceeded by decreases on other CAS-covered contracts. However, CAS publications including the CAS clause shed no light on how the offset technique may be related to mandatory changes, simultaneous accounting changes, multi-divisional accounting changes and changes affecting a diverse contractual mix.

Discussion

While the CAS Board explicitly advocates the use of the offset technique to preclude contract price changes under voluntary type, i.e., (a) (4) (B) changes, the technique can be equally useful in connection with mandatory changes, i.e., (a) (4) (A) type, if used for the same general purpose of netting out contract price changes and thus reducing the number of individual contract price adjustments required.

No specific method for applying the offset concept has been established. It remains the responsibility of the Administrative Contracting Officer to address each specific situation in a way that best accomplishes the overall objective. One method that may simplify the computation in many instances, as well as avoid the pitfalls described in item X of DPC 76-1, would be to compute the impact of a change by types of contracts (e.g., firm fixed price, cost type) and adjust as few contract prices as necessary within

each group before merging the net impact from each contract group with that of other groups. Different approaches may provide a better procedure in other cases. For example, contracts may be grouped according to the relative materiality of the impact of the change (also see DPC 76-1). This type of segregation can be helpful in identifying contracts which can be eliminated from further consideration.

Another issue concerns the extent to which the offset principle can be used when several organizational segments of a company are affected by the same accounting change. As a general rule whenever costs are flowing either from a higher organizational level or between segments, the offset universe may cover all affected segments. For example, a change that affects the flow of costs from a home office to several segments could offset CAS-covered contracts within all affected segments. However, accounting changes that only affect the flow of costs within individual divisions should be treated as changes within each division.

The combining, for offset purposes, of several accounting changes within a segment as long as they have the same effective date should also serve to reduce the number of necessary contract price changes. Although individual treatment of voluntary changes could maximize the potential for downward price adjustments, the government's interests are adequately protected if no overall price increase is paid by the United States.

In summary, for those aspects of offset situations where specific CAS Rules and Regulations do not exist, Contracting Officers are still charged with exercising their best judgment on each individual impact study in a way that protects the best interest of the Government and considers the equity, fairness and materiality of the matter.

Guidance

1. Contracts may be adjusted individually or cost increases and decreases may be offset to reduce the number of contract adjustments for both (a)(4)(A) and (a)(4)(B) changes.

2. Cost increases at one organizational segment of a company may be offset by decreases at another segment if the change causes costs to flow between the segments either directly or via a higher organizational level such as a home office.

3. Within a segment the effect of several changes may be combined in the offset consideration if the changes all take place at the same time.

4. When a mix of contract types is involved, grouping of contracts by type, by materiality of cost impact or other type segregation may often reduce the complexity of the problem and also reduce the number of price adjustments that must be made.

5. The Contracting Officer is responsible for assuring that the offset technique is applied judiciously so that the final cost to the government or to individual departments or agencies is not materially different from that which would have resulted if the contract prices had actually been adjusted.

6. Offsets affecting incentive contracts should be carefully reviewed to avoid material impacts on the incentive provisions.

SUBJECT: Interim Guidance for Measurement of Cost Impact
on Firm Fixed Price Contracts

Background

Paragraph (a) (4) (A) of the CAS clause provides for an equitable adjustment when accounting system changes result from the issuance of new cost accounting standards. Paragraph (a) (4) (B) of the CAS clause calls for negotiation of the terms and conditions under which a voluntary change to either a disclosed or established cost accounting practice will be made. Paragraph (a) (5) of the CAS clause provides for recovery with interest of any over payments that have resulted from a contractor's failure to comply with either a Cost Accounting Standard or his disclosed practices. These paragraphs are silent as to the mechanics of the computation.

The interpretive language found in 4 CFR 331.70(b) describes the remedies to be applied where noncompliances occur in connection with (a) (5) type adjustments under firm fixed price contracts. 4 CFR 331.70(b) explicitly requires the use of original cost estimates from the time of negotiation of the contract adjusted to what they would have been had the contractor proposed on the basis of the practices actually used.

ASPM No. 1 (9A6 and 9A7) in addressing the general subject of the pricing of changes advocates the use of estimates to complete at the time the change is made rather than the original estimates.

Discussion

Although there is a certain theoretical purity to the use of original cost estimates for adjusting fixed price contracts for mandatory and voluntary changes, there are several serious impediments to that approach that are intrinsic to fixed price contracting. While the parties to a fixed price contract have agreed to a total price, there is often no agreement as to how much of the price represents cost and how much profit and seldom a meeting of the minds on the amount of any individual element of cost. This will be particularly so if the award was based on adequate price competition. Further, many fixed price contracts will have undergone numerous price changes due to engineering modifications and other changes. In such cases, tracking of an individual cost element may prove virtually impossible.

There is also the danger that the confusion resulting from the attempt to reconstruct the original data will provide an opportunity to reprice loss portions of contract performance that have elapsed prior to the point of the change.

The use of original cost estimates in cases involving noncompliances on Firm Fixed Price contracts may be more feasible where the noncompliant practice dates back to the beginning of the contract. However, there will still be occasions when tracking and cost identity problems will be almost insurmountable.

Guidance

Cost adjustments under either mandatory, (a)(4)(A), or voluntary, (a)(4)(B), changes should generally be the net difference between the current estimated cost to complete using the old accounting methods and the same estimate reconstructed to reflect the new methods.

Adjustments relating to noncompliance, (a)(5), under firm fixed price contracts must comply with the CAS Board's requirement to use original cost estimates reflecting the noncompliant and compliant treatments. Should this prove impracticable, the problem should be forwarded through appropriate channels to the CAS Working Group.

2/2/77

SUBJECT: Retroactive Implementation of Cost Accounting Standards When Timely Compliance is Not Feasible

Background

There are two significant dates in the implementation of cost accounting standards, the "effective" date and the "applicability" date. Working Group (W.G.) guidance paper #76-7 which provides discussion and guidance on these dates states that the effective date "Designates the point in time when the pricing of all future CAS-covered procurement must reflect the requirements of the newly promulgated standard . . ."; and the applicability date ". . . marks the beginning of the period when the contractor must actually change the accounting and reporting systems to conform to the standard." The applicability date of most standards is the beginning of the contractor's next accounting period after receipt of a CAS-covered contract following the effective date of the standard.

Discussion

There may be a few unusual situations when it is virtually impossible for a contractor to comply with a particular standard at its applicability date because the standard requires a major revision to a segment of the contractor's cost accounting system. In this instance, attempting to forecast the impact of the standard on a negotiated contract to be entered into after the effective date of the standard could be inequitable to either party. For example, CAS Standard 410 (Allocation of Business Unit G&A Expenses to Final Cost Objectives) was promulgated in final form on April 16, 1976, with an effective date of October 1, 1976, and an applicability date at the start of the next fiscal year beginning after January 1, 1977. Some contractors, for various reasons, have a fiscal year beginning on January 2 or 3, 1977. Therefore, the applicability date for those contractors was only about three months after the effective date (assuming that a CAS-covered contract was received in the interim period). There has been an indication that some of these contractors were unable to accomplish a major revision to their G&A expense pool and change to an appropriate cost input base in the time available. In the meantime, contract proposals received after October 1, 1976, have been required to be negotiated on a cost input basis and in these instances the accounting and reporting systems must be changed effective January 2 or 3, 1977, thereby creating a difficult condition.

Guidance

In unusual situations where a contractor can demonstrate to the satisfaction of the ACO, that it is virtually impossible for the contractor to comply with the effective or applicability dates of a standard the following guidance should be followed:

1. The ACO shall establish a specific date for the contractor to make the necessary changes to his estimating, accounting and reporting systems to be in compliance with the standard.

2. Negotiation of new firm fixed-price contracts after the effective date of the standard (but prior to the changes made in 1 above) should be conducted using the accounting practice employed by the contractor prior to the standard. The terms of these contracts should include a provision for price adjustment, retroactive to the applicability date, for any significant cost impact (increase or decrease) resulting from changing the accounting practice to comply with the standard.

3. After the effective date of the standard (but prior to the changes made in 1 above) negotiation of ceilings or target costs and fees or profit for new cost type or flexibly priced contracts should be conducted using the accounting practice employed by the contractor prior to the standard. The contract terms of these contracts should include a provision for a ceiling or target cost adjustment (and adjustment of fee or profit, if appropriate) for any significant estimated cost impact resulting from changing the accounting practice to comply with the standard. In addition, after the necessary changes to the accounting system are made in accordance with 1 above, these changes must be made retroactive to the applicability date of the standard for costs allocated to these contracts.

4. When appropriate, changes in the contractor's Disclosure Statement to reflect the cost accounting practices required by the standard should also be accomplished by the date established in 1 above.

5. When the above procedures are followed there will be no noncompliance reporting, and equitable adjustments computed as of the applicability date of the standard are in order.

2/2/77

SUBJECT: Interim Guidance for the Implementation of
CAS 410, Allocation of Business Unit General
and Administrative Expenses to Final Cost
Objectives

Background

The standard provides criteria for allocating G&A to final cost objectives. It defines G&A expenses, provides guidelines for determining whether a particular expense should be included in the G&A expense pool and establishes cost input as the acceptable base for allocating G&A expenses. Contractors currently using sales or cost of sales (output) as a base are permitted to select one of two alternative procedures for changing to cost input. One method allows the immediate changeover to cost input on the date the standard's provisions must be applied; the other, allows a special transition which defers the complete changeover to cost input until all contracts received prior to the applicability date are completed. It is unmistakeably clear, however, that the CAS Board's objective is to ultimately have all G&A, as defined in the standard, allocated to CAS-covered contracts on the basis of cost input.

Discussion

The CAS Board established an effective date of October 1, 1976 for CAS 410. To allow contractors sufficient time to prepare for compliance, the application of the standard was deferred. The earliest date a contractor can be compelled to change his accounting practices to comply is the beginning of his first fiscal year following January 1, 1977. Consequently, a contractor using the calendar year as his normal accounting period initially would be required to comply January 1, 1978. However, if the contractor's fiscal year begins on July 1, the earliest required date for compliance would be July 1, 1977. Although not explicitly stated in the standard, it is important to know that a contractor must receive a CAS-covered contract on or after the standard's effective date before he has to apply the standard. In the examples cited above, neither contractor would be required to apply the standard on the specified dates if no new CAS-covered contract had been received since the standard became effective.

The effective date of the standard also has special significance regarding the pricing of new procurements and for adjusting existing contract prices. In this regard, only those CAS-covered contracts existing on the effective date will be eligible for an equitable price adjustment. Except where the special transition method is used, contracts with award dates following the effective date of the standard and having performance periods extending beyond the date the standard must be applied, are to be estimated as follows:

1. Current G&A allocation base will be used to estimate, accumulate and report on contracts between the award and applicability dates.
2. Cost input base will be used to estimate, accumulate and report on the remaining contract effort (applicability date through contract completion).

Under the special transition method for changing from a cost of sales or sales base to a cost input base, permitted by Appendix A of the standard, contractors will continue to use their current G&A allocation base to price contracts received up to the date CAS 410 must be followed. Contracts awarded on or after the applicability date will be priced using a cost input G&A base. This method effectively eliminates the need for an equitable price adjustment for this change since existing contracts priced on the basis of a sales or cost of sales G&A base will not be repriced to reflect the use of a cost input base. Instead, these contracts will remain on the sales or cost of sales base until completion.

Other changes required by the standard may require equitable adjustments whether the transition method is used or not: (1) when a contractor is required to change from one cost input base to another; e.g., total cost input to value added; and (2) where items do not satisfy the definition of G&A expense but have previously been classified as G&A must be reclassified in accordance with 410.40(d).

During the special extended transition period (begins when the standard is initially applied for accounting and reporting purposes and ends at the completion of the final contract priced on the basis of cost of sales or sales) two different bases are used to allocate a single pool of G&A expenses within an accounting period - cost of sales for the old contracts, cost input for contracts awarded on or after the date the standard is applicable.

The two bases used in a given accounting period during transition are not mutually exclusive but tend to overlap. That is, some of the same dollars may be included in both cost input and in cost of sales within the same accounting period. When this occurs, the possibility of allocating more G&A dollars to cost objectives than were expended during the accounting period is very real. The overallocation of G&A will more than likely occur because the G&A rates will be applied to an aggregate of contract work that exceeds the amount included in the individual bases used to determine the rates. In order to prevent windfalls and to provide equity to both parties, the standard requires the establishment of an inventory suspense account which shall, when certain conditions are met, be amortized in accounting periods subsequent to the transition period. The amortization of the inventory suspense account shall be used to reduce the G&A expense pool of the qualifying cost accounting periods. Notwithstanding the inventory suspense account provision, questions have been raised regarding the allowability under ASPR XV, Part 2 of any overallocated expenses.

The standard also defines G&A as those expenses incurred for the general management and administration of a business unit as a whole. They must be allocated to final cost objectives on a base that measures the total activity of the business unit. Similar significant expenses whose beneficial relationship to cost objectives can be measured best on a base different from total activity are to be excluded from the G&A expense pool. For the expenses remaining in the G&A expense pool, the standard prescribes the use of one of three cost input bases: (1) total cost input (2) value-added and (3) single elements. Conditions relating to the appropriate use of the three bases are described in the standard.

Under the standard, contractors may elect to include independent research and development (IR&D) costs, bidding and proposal (B&P) costs and selling costs in the G&A expense pool. The contractors also have the option to account for these expenses individually or in the aggregate in separate pool(s) and allocate them to cost objectives on a base(s) other than cost input. Where the latter alternative is selected the standard requires that such expenses will be included in the G&A expense allocation base. If IR&D and B&P expenses are allocated on a base other than cost input, a question is raised as to whether the standard conflicts with ASPR 15-205.3 and 15-205.35 which provide that IR&D and B&P costs are not to be burdened with G&A. Attachment A clarifies this issue and demonstrates that no conflict exists.

The standard covers the treatment of items produced for stock after the applicability date but does not provide guidance for the treatment of items held in inventory on the first date the contractor must apply the standard. If such inventories are substantial or a disproportionate amount of these items are included in certain contracts, an inequitable allocation of G&A could result. It would appear that equity would require the inclusion of the inventory items in the G&A base in some future cost accounting period.

Guidance

Contractors whose existing practices require the allocation of G&A on either a sales or cost of sales basis may (i) use the optional transition method prescribed by Appendix A, CAS 410 or (ii) immediately change to a cost input base for all work to be performed after the applicability date and seek such equitable adjustment as may be appropriate under Paragraph (a)(4)(A) of the CAS contract clause.

Procurement officials must exercise special care in reviewing contractor's proposals submitted during the period when this election should be made (effective date through applicability date) to assure that contractors do not unwittingly select the transition method. For example, during this period a contractor submits a proposal with a performance period extending beyond the applicability date. If the entire contract is priced using the contractor's current practice of allocating G&A on the basis of sales or cost of sales, this contractor has effectively selected, perhaps inadvertently, the special transition method. Therefore, contracting officers should advise contractors regarding the significance of the G&A allocation method used in preparing the estimate for the initial contract to which this standard applies. Requesting the contractor to submit a written confirmation of his election is an appropriate way to preclude any misunderstanding as to his intentions.

As noted in the discussion section, use of the two allocation bases during the transition will in all likelihood result in an overallocation of G&A. This condition will apply only to those contractors who elect the optional transition method rather than the equitable adjustment procedures. Any overallocated G&A resulting exclusively from the use of the transition method will not be questioned at this time. This interim position recognizes that the overallocated amount is inherent in

the standard's requirements. This position also recognizes the CAS Board's contention that the establishment of an inventory suspense account actually prevents any over-reimbursements. This aspect of the standard is under review and the above position may be revised.

CAS 410 requires inclusion of IR&D/B&P costs in the G&A input base when IR&D/B&P costs are accounted for in a separate pool and allocated on a base different from G&A. When distributing G&A expense to a contract, all properly allocable IR&D/B&P costs, including those in excess of negotiated ceilings, should be included in the cost base used to compute the G&A expense for that contract. Although IR&D/B&P costs over ceiling are themselves unallowable, they are still used as part of the total cost input base for computing G&A expense. As explained in Attachment A, this procedure is simply a mechanism to allocate G&A expenses to final cost objectives.

The standard requires that items produced for stock be included in the input base at the time of production. Therefore, stock items which are in inventory when the standard becomes applicable will not be allocated their share of G&A. To remedy this situation items produced for stock and included in the inventory on the date the standard becomes applicable should be included in the G&A base in the period the items are assigned to final cost objectives.

ATTACHMENT ATHE EFFECTS OF CAS 410 UPON THE ALLOCATION
AND ALLOWABILITY OF G&A EXPENSES

CAS 410.50(f) states "Cost input shall include those expenses which by operation of this standard are excluded from the G&A expense pool and are not part of a combined pool of G&A expenses and other expenses allocated using the same allocation base."

The illustration contained in 410.60(c)(4) states "Business Unit C has accounted for and allocated IR&D/B&P costs in a cost pool separate and apart from the G&A expense pool. C may continue to account for these costs in a separate cost pool under the provision of this standard. If C is to use a total cost input base, these costs when accounted for and allocated in a cost pool separate and apart from the G&A expense pool will become part of the total cost input base used by C to allocate the G&A expense pool."

The above cited sections of CAS require that IR&D and B&P, or any other cost for that matter, which is distributed in a way that is different from the way in which G&A is distributed, must itself become part of the total G&A input base. For example an IR&D/B&P base that omits major sub-contracts or service contracts that are included in the G&A base would be a different base. When that situation pertains the procedure to be followed is:

a. distribute all IR&D/B&P to contracts including amounts of IR&D/B&P which are unallowable because they exceed a previously agreed ceiling limitation.

b. distribute G&A expense to contracts on a cost input base which includes the IR&D/B&P in a, above.

At this point it would appear that the G&A expense which was drawn to a contract by the unallowable amounts distributed in a, above would also be unallowable. The language of ASPR 15-203(c) supports this view in its statement that, "... Once an appropriate base for the distribution of indirect costs has been accepted, such base shall not be fragmented by the removal of individual elements. Consequently, all items properly includable in an indirect cost base should bear a pro-rata share of indirect costs irrespective of their acceptance as Government contract costs."

Although the combination of the CAS required distribution and 15-203(c) would seem to lead to the conclusion that the G&A expense attracted to contracts by unallowable IR&D/B&P dollars would, in itself, be unallowable, it must be recalled that, prior to the issuance of CAS 410, ASPR 15-203 (c) existed in combination with ASPR 15-205.35(b). That subparagraph defines the composition of IR&D costs to "... include not only all direct costs, but also all allocable indirect costs except that general and administrative costs shall not be considered allocable to IR&D." The combined effect of these two ASPR provisions was that no G&A expense was allocated to IR&D/B&P and, therefore, it was not necessary to disallow G&A due to IR&D/B&P expense being disallowed. That intent was not changed by CAS 410 since the CAS Board indicates in its prefatory comment 3(b) to the standard that the G&A expense allocation is considered to be an allocation to a final cost objective, i.e., the contract, and that the IR&D/B&P included in the base dollars is only there as part of the allocation mechanism. It is not to be considered a final cost objective in and of itself. Therefore, CAS standard does not mandate that the G&A expense attracted by dollars representing unallowable IR&D/B&P be disallowed. Allowing these G&A dollars is DoD's procedure. It accomplishes substantially the same result as presently contemplated by ASPR.

This concept raises a broader question as to whether G&A expense related to unallowable base cost of a type other than IR&D/B&P is also allowable under CAS 410. The answer to that resides in the next to last paragraph of prefatory comment no. 4 relative to CAS 405. That paragraph indicates the CAS Board's understanding that the allowance or disallowance of these costs is subject to the cognizant agency's cost principles.

The following model attempts to illustrate the effects of these factors:

- a. treatment prior to and under CAS 410
- b. an allocation base for IR&D/B&P that differs from the base for allocation of G&A
- c. unallowable IR&D/B&P costs
- d. other unallowable costs

The model is based on the following assumptions:

1. There are three contracts each incurring costs of:

Labor	\$ 200,000
Burden	400,000
Material	<u>150,000</u>
	<u>\$ 750,000</u>

2. There is a company-wide General & Administrative Expense Pool of \$300,000.

3. There is a company-wide IR&D/B&P Pool with expenditures of \$750,000. The pool is subject to a ceiling of \$500,000.

4. \$50,000 of unallowable material charges are properly allocable to Contract #1.

5. Contract #2 is a services contract and is not part of the contractor's IR&D/B&P Base.

	<u>Total Costs</u>		<u>Contract #1</u>		<u>Contract #2</u>		<u>Contract #3</u>	
	<u>Incurred</u>		<u>Allocated</u>	<u>Paid</u>	<u>Allocated</u>	<u>Paid</u>	<u>Allocated</u>	<u>Paid</u>
Labor	\$ 600,000		\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000
Burden	1,200,000		400,000	400,000	400,000	400,000	400,000	400,000
Material	<u>450,000</u>		<u>150,000</u>	<u>100,000</u>	<u>150,000</u>	<u>150,000</u>	<u>150,000</u>	<u>150,000</u>
S-T	\$2,250,000		\$ 750,000	\$ 700,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000
IR&D	<u>750,000</u>		<u>375,000</u>	<u>250,000</u>	<u>-0-</u>	<u>-0-</u>	<u>375,000</u>	<u>250,000</u>
S-T	\$3,000,000		\$1,125,000	\$ 950,000	\$ 750,000	\$ 750,000	\$1,125,000	\$1,000,000
G&A	<u>300,000</u>		<u>100,000</u>	<u>93,335</u>	<u>100,000</u>	<u>100,000</u>	<u>100,000</u>	<u>100,000</u>
	<u>\$3,300,000</u>		<u>\$1,225,000</u>	<u>\$1,043,335</u>	<u>\$ 850,000</u>	<u>\$ 850,000</u>	<u>\$1,225,000</u>	<u>\$1,100,000</u>

G&A Rate:
 $\frac{300,000}{2,250,000} = 13.33\%$

	<u>Contract #1</u>	<u>Contract #2</u>	<u>Contract #3</u>	<u>Total</u>
G&A Paid Computation				
Total Labor Mat'l & Burden Incurred	\$ 750,000	\$ 750,000	\$ 750,000	\$2,250,000
Less Unallowable Mat'l				
G&A Base	$\frac{50,000}{\$ 700,000}$	$\frac{-0-}{\$ 740,000}$	$\frac{-0-}{\$ 750,000}$	$\frac{50,000}{\$2,200,000}$
X Rate 13.33%=G&A Paid	<u>\$ 93,335</u>	<u>\$ 100,000</u>	<u>\$ 100,000</u>	<u>\$ 293,335</u>
G&A Not Paid Computation:				
Unallowable Material	<u>\$ 50,000</u>			<u>\$ 50,000</u>
X G&A Rate 13.33%	<u>\$ 6,665</u>			<u>\$ 6,665</u>

	<u>Total Costs</u>		<u>Contract #1</u>		<u>Contract #2</u>		<u>Contract #3</u>	
	<u>Allocated</u>	<u>Paid</u>	<u>Allocated</u>	<u>Paid</u>	<u>Allocated</u>	<u>Paid</u>	<u>Allocated</u>	<u>Paid</u>
Labor	\$ 600,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000
Burden	\$1,200,000	400,000	400,000	400,000	400,000	400,000	400,000	400,000
Material	<u>450,000</u>	<u>100,000</u>	<u>150,000</u>	<u>150,000</u>	<u>150,000</u>	<u>150,000</u>	<u>150,000</u>	<u>150,000</u>
S-T	\$2,250,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000
IR&D	<u>750,000</u>	<u>375,000</u>	<u>250,000</u>	<u>-0-</u>	<u>-0-</u>	<u>375,000</u>	<u>250,000</u>	<u>250,000</u>
S-T	\$3,000,000	\$1,125,000	\$ 950,000	\$ 750,000	\$ 750,000	\$1,125,000	\$1,000,000	\$1,000,000
G&A	<u>300,000</u>	<u>112,500</u>	<u>107,500</u>	<u>75,000</u>	<u>75,000</u>	<u>112,500</u>	<u>112,500</u>	<u>112,500</u>
	<u>\$3,300,000</u>	<u>\$1,237,500</u>	<u>\$1,057,500</u>	<u>\$ 825,000</u>	<u>\$ 825,000</u>	<u>\$1,237,500</u>	<u>\$1,112,500</u>	<u>\$1,112,500</u>
G&A Rate: <u>300,000</u> = 10% <u>3,000,000</u>								
G&A Paid Computation: Labor, Mat'l & O/H Incurred								
	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$ 750,000	\$2,250,000	
Less Unallowable Mat'l	<u>50,000</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>50,000</u>	<u>50,000</u>	
	<u>\$ 700,000</u>	<u>\$ 750,000</u>	<u>\$ 750,000</u>	<u>\$ 750,000</u>	<u>\$ 750,000</u>	<u>\$2,200,000</u>	<u>\$2,200,000</u>	
Plus Gross IR&D	<u>375,000</u>	<u>N/A</u>	<u>375,000</u>	<u>375,000</u>	<u>375,000</u>	<u>750,000</u>	<u>750,000</u>	
	<u>\$1,075,000</u>	<u>\$ 750,000</u>	<u>\$ 750,000</u>	<u>\$1,125,000</u>	<u>\$1,125,000</u>	<u>\$2,950,000</u>	<u>\$2,950,000</u>	
X 10% = G&A Paid	<u>\$ 107,500</u>	<u>\$ 75,000</u>	<u>\$ 75,000</u>	<u>\$ 112,500</u>	<u>\$ 112,500</u>	<u>\$ 295,000</u>	<u>\$ 295,000</u>	
G&A Not Paid:								
Unallowable Other Than IR&D	<u>\$ 50,000</u>	<u>\$ 50,000</u>	<u>\$ 50,000</u>	<u>\$ 50,000</u>	<u>\$ 50,000</u>	<u>\$ 50,000</u>	<u>\$ 50,000</u>	
X 10% G&A Rate = G&A Not Paid	<u>\$ 5,000</u>	<u>\$ 5,000</u>	<u>\$ 5,000</u>	<u>\$ 5,000</u>	<u>\$ 5,000</u>	<u>\$ 5,000</u>	<u>\$ 5,000</u>	

ANALYSIS OF PRE & POST 410 DIFFERENCES

	<u>Contract #1</u>	<u>Contract #2</u>	<u>Contract #3</u>	<u>Total</u>
Amount Pd before 410	\$ <u>1,043,335</u>	\$ <u>850,000</u>	\$ <u>1,100,000</u>	\$ <u>2,993,335</u>
Amount Pd under 410	\$ <u>1,057,500</u>	\$ <u>825,000</u>	\$ <u>1,112,500</u>	\$ <u>2,995,000</u>
Increase or (Decrease)	\$ <u>14,165</u>	\$ <u>(25,000)</u>	\$ <u>12,500</u>	\$ <u>1,665</u>

Analysis of Changes:

	<u>Contract #1</u>	<u>Contract #2</u>	<u>Contract #3</u>	<u>Total</u>
Due to Inclusion of all IR&D in the G&A Base	\$ 12,500	\$ (25,000)	\$ 12,500	\$ -0-
Due to lower G&A rate on Unallowables as a result of including all IR&D in the G&A Base	\$ <u>1,665</u>	\$ <u>-0-</u>	\$ <u>-0-</u>	\$ <u>1,665</u>
Total Increase or (Decrease)	\$ <u>14,165</u>	\$ <u>(25,000)</u>	\$ <u>12,500</u>	\$ <u>1,665</u>

3/29/77

Subject: Interim Guidance - Deliberate Noncompliance
and Inadvertant Noncompliance

References: W.G. 76-8
ASPR 3-1212
ASPR 3-1214

Background

Paragraph (a)(5) of the CAS Clause requires an adjustment of contract price or of cost allowance if increased costs to the Government occur because the contractor fails to follow disclosed practices or cost accounting standards. Increased costs, plus interest are to be recovered. Paragraph (g) of 4 CFR 331.70 Interpretation, provides, however, that if the failure to follow Standards or disclosed practices is inadvertent, it is only necessary to recover the difference between cost increases and cost decreases plus interest.

The significance of 4 CFR 331.70(g) is that deliberate noncompliances are treated differently from inadvertent noncompliances. Thus, when deliberate noncompliance takes place the contractor must repay excess costs plus interest on each CAS contract which has experienced increased costs due to noncompliance. And, there can be no offset against CAS contracts which may have experienced decreases as a result of deliberate noncompliance. On the other hand, if the noncompliance was inadvertent, the increased costs may be offset to the extent the noncompliance results in decreased costs on other CAS contracts. (See W.G. 76-8 for discussion of the use of offset in contract adjustment.)

Discussion

Clearly, in a noncompliance situation it will be in the contractor's interest to label the noncompliance as inadvertent, because it will minimize his cost liability to the Government through use of offset. While it is not possible to anticipate the many kinds of case histories ACOs will be required to judge, some basic questions can be discussed.

For example, if a contractor noncomplies with a disclosed practice or Standard, can it be concluded that, because he had knowledge of the requirements of the Standard or the disclosed practice, he is precluded from using the excuse inadvertence? The answer is no. He can claim inadvertence provided he demonstrates that the noncompliance resulted

from failure of his employees to follow company policy and instructions. He should be required to demonstrate, however, that policy and instructions were made known to concerned employees and, that there was a good faith effort on his part to implement those policies.

A situation might also arise when an ACO finds a non-compliance, known to the contractor, brings it to the attention of the contractor and convinces him that a non-compliance truly exists. In this example the noncompliance should also be considered inadvertent.

ACOs may encounter situations in which similar noncompliances, any one of which would not be considered deliberate in and of itself, occur frequently. A sufficiently repetitious pattern would support a conclusion that the violations were deliberate. The materiality of the total occurrences should also be considered.

Another situation arises when the contractor and ACO are not in agreement regarding the contractor's compliance with a Standard and the case goes to the Armed Services board of contract Appeals (ASBCA). If the contractor appeals the ACO decision, and ultimately wins, there is no problem; because he will have been found to be in compliance. But, what if he loses? One solution would be to consider the noncompliance inadvertent on the basis that the contractor fully believed he was in compliance. It could be argued that this would encourage appeals to the ASBCA, whether they have merit or not, and a case might be made that contractors should bear the risk of such appeals because if they win they suffer no loss. If they lose, they accept the result of deliberately noncomplying. However, this approach may be overly harsh. On balance, it appears more reasonable to consider noncompliance to be inadvertent when appeals are taken, unless it is determined that the appeal is based on grounds that are clearly frivolous. Generally, the time and cost involved in taking appeals to the ASBCA is adequate protection from abusing this remedy just to avoid the effect of deliberate non-compliances. At the same time, it appears reasonable to assume that the CAS legislation and the CAS Board's rules are primarily intended to protect the Government, not penalize contractors by extracting from them, costs that are otherwise reasonable and allowable.

A different example would be when a contractor is in noncompliance with disclosed practices, because he has changed an accounting practice and failed to advise the ACO as required. If the contractor subsequently takes necessary action to establish the change in accordance

with ASPR 3-1214 and the contract clause in 7-104.83(b) what should the ACO do about the period preceding the contractor's notification and the ACO's determination as to adequacy and compliance? There is no doubt the contractor deliberately intended to follow the new practice rather than that in his established disclosure statement. In this case, there appears to be no excuse for the contractor to go ahead with a change and not give notice to the ACO as required. Deliberate noncompliance seems to be the only reasonable determination that could be made for this period.

Guidance

Contractors should be notified at the earliest practicable time whether noncompliances are considered to be deliberate or inadvertent.

Deliberate noncompliance should be determined when a contractor has not made a reasonable effort to acquaint responsible management and other affected personnel of the requirements of CAS and has not established appropriate policies for carrying out these requirements as established in pertinent contract and ASPR provisions. When reasonable effort has been made by the contractor and noncompliance takes place, the ACO, generally, should determine the non-compliance to be inadvertent.

Inadvertent noncompliance should also be the finding when a previously unrecognized noncompliance comes to light and the contractor takes action to make the correction.

Repetitive noncompliances of like or similar character would constitute persuasive evidence in support of a determination that the noncompliance was deliberate.

Noncompliances which are formally appealed, and the appeal is subsequently denied by the Board of Contract Appeals, should be considered inadvertent except in cases where it is determined that the appeal is based on grounds which are clearly frivolous.

Voluntary changes in accounting practices should normally be considered deliberate noncompliances when they are implemented earlier than 60 days after the time the ACO has received notice as provided in ASPR 3-1214. (A different time period may be mutually agreed to by the ACO and contractor.)

Following this time period they should be considered as voluntary changes, or if the ACO determines the changes to be noncompliant, they shall be considered as inadvertent noncompliances.

SUBJECT: Interim Guidance on the Applicability of CAS 405 to Costs Determined Unallowable on the Basis of Allocability

Background

CAS 405 provides that a contractor must identify unallowable costs. Specifically, paragraph 405.40(a) provides that:

"Costs expressly unallowable or mutually agreed to be unallowable including costs mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract."

An unallowable cost is defined in paragraph 405.30(a)(4) as:

"Any cost which, under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost reimbursements, or settlements under a Government contract to which it is allocable."

It has been suggested that the last five words of paragraph 405.30(a)(4), ". . . to which it is allocable." can be interpreted to mean that CAS 405 does not apply to costs determined unallowable by the Government on the basis of allocability, and thus a contractor is not required to identify such unallowables.

Discussion

It is the intent of the Cost Accounting Standards Board that CAS 405 apply to all costs determined unallowable, including those so determined on the basis of allocability. This intent is consistent with the Standard's purpose as stated in paragraph 405.20 of the Standard. Thus, the definition of an "unallowable cost" applies to any cost which a contractor assigns to Government contracts which is determined to be unallowable for whatever reason; i.e. law, regulation, contract terms, or allocability.

Going one step further, assume that a contractor proposes a cost on a contract and it is questioned solely on the basis of allocability. The contractor has two options: (1) he can agree with the Government that the cost is not properly allocable and therefore unallowable, or (2) he can claim that the cost is allocable and therefore allowable. In the first case the cost is unallowable by mutual agreement and in accordance with CAS 405.40(a) must be identified. In the second instance, if both parties hold their ground and the cost becomes the subject of a dispute, then in accordance with CAS 405.40(b) it becomes designated as unallowable and must be identified if used in computing any billing claim or proposal. In the second situation it would be inconsistent for the contractor to claim that the cost is allocable while simultaneously claiming that he does not have to identify it per CAS 405 because it is not allocable.

Guidance

Contractors should be required to identify all unallowable claimed costs in accordance with CAS 405, including costs determined unallowable by the Government on the basis of allocability. If a contractor refuses to identify unallowable costs including those determined not allocable, the contractor is in noncompliance and the procedures set forth in ASPR 3-1212 should be followed.

SUBJECT: Interim Guidance on Early Implementation of
New Cost Accounting Standards Issued by the CAS
Board

Background

Interim Guidance Paper W.G. 76-7 provided guidance on the effective date and the applicability date of a new Standard. With regard to contractor's proposals, W.G. 76-7 stated that contract effort occurring after the effective date but before the applicability date, should be priced using the contractor's old accounting practice. Effort projected to occur on or after the applicability date should be priced in compliance with the new Standard. Also, equitable adjustment for those CAS-covered contracts in existence when a Standard becomes effective should cover the period from the date the Standard becomes applicable through contract completion.

The purpose of this paper is to deal with situations when contractors wish to implement new Standards before they become applicable.

Discussion

Generally, two opposing approaches have been proposed. First is the proposal that contractors should be allowed to implement a new Standard any time after its effective date and be entitled to an equitable adjustment, even though the mandatory implementation (applicability) date has not passed. The opposite proposal is that early implementation of new Standards must be considered a voluntary change and therefore the Government should not pay any increased costs resulting from the changed practice.

Neither of the two extreme positions is appropriate. In the first position, the Government does not incur an obligation to pay increased costs for effort prior to the applicability date; consequently, the contractor is not entitled to equitable adjustments (i.e., increased costs) for the period between the effective date and the applicability date. The second position prohibits the contractor from receiving an equitable adjustment for that period running from the applicability date of the Standard to completion of the contract, merely because he had implemented the change before the applicability date. This is inequitable and unnecessarily restrictive.

Guidance

Unless precluded by contract provisions, a contractor may implement a new Cost Accounting Standard on or after its effective date, but prior to its applicability date. In this instance the following guidance is applicable:

a. The change will be administered as a voluntary change prior to the applicability date. No increased costs to the Government incurred during this period will be allowed.

b. The contracting parties will be entitled to an equitable adjustment for those effects of the change which impact existing contracts on or after the applicability date.

In summary, contractors may implement new Standards early, but, the Government will not pay increased costs that occur prior to the applicability date.

3/29/77

SUBJECT: Interim Guidance on the Influence of CAS
Regulations on Contract Terminations

Background

It is reasonable to expect with the passage of time that more and more contracts being terminated will be CAS-covered contracts. Questions have arisen as to whether there is a conflict between DoD's heretofore normal termination cost practices as primarily described in ASPR 15-205.42 and CAS Board Regulations, particularly Standards 401, 402 and 406.

Discussion

CAS 401 generally requires that costs be accumulated and reported in the same way that they have been estimated. Since the cost estimates leading up to the signing of a contract are ordinarily predicated upon the contract being performed to completion, many of the costs contained in the termination claim are likely to be arranged in ways that are quite different from the cost presentation contained in the original estimate.

Under the requirements of CAS 402 "like costs" in "like circumstances" must be consistently classified as either direct only or indirect only. Under ASPR 15-205.42, termination claims will often include costs such as settlement expenses, unexpired lease costs, etc., as direct charges while those costs or functions would have been charged as indirect costs if the contract had run its course.

DoD's view is that normal termination procedures violate neither CAS 401 nor 402. The termination of a contract creates a situation that is totally unlike the completion of a contract. It is not reasonable or logical to extend the requirement for consistency with an estimate to an event which was never anticipated in the estimate. The consistency requirement would be violated, however, if a contractor had several similar terminations and handled them in dissimilar ways. It may be advisable for a contractor to document his termination accounting procedures as a part of his disclosed practices. The circumstances usually associated with a termination also mitigate the requirements of CAS 402 since the "like circumstances" referred to in the Standard are generally lacking.

Another concern has been expressed as to whether CAS 406 conflicts with the suggestion contained in ASPR 15-203(e)(i) that a period shorter than a year may be proper for indirect

cost rate computations when contract performance involves only a minor portion of the year. CAS 406 requires that a contractor use his fiscal year as his cost accounting period. CAS 406 does, indeed, prohibit the use of a shorter accounting period for CAS-covered contracts. It has generally been DOD's policy to employ full year indirect cost rates or annualized representations of the same. That policy is now a requirement. This means that a contract terminated and settled early in an accounting year may use an estimate of overhead for the remainder of the year that together with the incurred historical costs represents a full fiscal year.

DoD believes that contrary to the notion that Cost Accounting Standards conflict with and overrule our termination procedures, the Standards tend to support them. In CAS 410.50(j), for example, when a final cost objective benefits significantly more or less from G&A than the normal allocation would reflect, a special allocation to the particular final cost objective is advocated. Both the special pool and base are then to be excluded from the overall G&A rate computation. CAS 403 and 405 are also supportive of normal termination procedures in their advocacies of allocation methods reflecting causal and beneficial relationships and direct associations of costs.

Guidance

Normal DoD termination costing procedures as detailed in ASPR 15-205.42 are still in effect. Termination Contracting Officers should assure themselves that within the context of termination situations consistency is honored to the extent that circumstances are similar. Over-head Rates must represent a full accounting period.

SUBJECT: Interim Guidance on Applicability of Cost
Accounting Standards to Letter Contracts

Background

The Cost Accounting Standards (CAS) clause (ASPR 7-104.83 (a)) provides, in part, the following requirement:

. . . Comply with all Cost Accounting Standards in effect on the date of award of this contract or if the contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the contractor's signed certificate of current cost or pricing date . . .

Questions have arisen regarding the application of CAS to letter contracts. First, does CAS apply to letter contracts, and if so, when? Second, what significance does definitization of a letter contract have?

Discussion

Does CAS apply to letter contracts? Letter contracts are not specifically commented on in Public Law 91-379, CASB promulgations or ASPR sections relating to CAS. ASPR, Section VII, Part 8, include all clauses known to be appropriate for the definitive contract which is contemplated. The CAS clause at ASPR 7-104.83(a) provides, in part, that CAS applies as of the date of award or on the date of final agreement on price as shown on the signed certificate of current cost or pricing data, unless the contract would otherwise be exempt. Since certified cost or pricing data is not normally submitted prior to the award of a letter contract, the awarding of the letter contract (if the definitized contract should be subject to (CAS)) would require inclusion of the CAS clause and be subject to CAS requirements at contract inception.

What is the significance of the definitization of a letter contract? Definitization of a letter contract is a contract modification not a new award; therefore, definitization would not trigger (activate) Standards issued subsequent to the letter contract award date.

Guidance

CAS is applicable to letter contracts as of the date of award unless it has been determined that the contract is excluded under one of the exemptions from CAS requirements. Definitization of the contract would not trigger (activate) any new Standards since definitization is a contract modification rather than a new contract. (See Interim Guidance Paper W.G. 76-2).

SUBJECT: Identification of CAS Contract Universe at a Contractor's Plant

Background

Whenever a contractor makes a change to his disclosed or established accounting practices or is determined to be in noncompliance, the Administration of CAS clause, ASPR 7-104.83(b), requires him to submit a cost impact proposal. An integral part of the cost impact proposal is the list of CAS-covered contracts and subcontracts which will be affected by the change or noncompliance.

Discussion

The General Accounting Office (GAO), in its final report, entitled "Status Report to the Congress on the Cost Accounting Standards Program - Accomplishments and Problems," found that auditors were spending an inordinate amount of time verifying the completeness and accuracy of the lists submitted by contractors. The GAO recommended that the DoD develop a procedure for identifying all the CAS-covered contracts and subcontracts at a particular contractor's plant.

Inherent in the Administration of CAS clause is the responsibility of a contractor to supply accurate and complete lists of his CAS-covered business. However, to preclude any misunderstanding and a consequent loss of time, the following guidance is provided.

Guidance

In order to comply with the requirements of the Administration of CAS clause, ASPR 7-104.83(b), contractors should be required to maintain a system for identifying accurately and completely all contracts and subcontracts which contain the Cost Accounting Standards clause, 7-104.83(a). The ACO should ensure that the contractor has such a system and that it is functioning effectively.

SUBJECT: Interim Guidance for Implementation of Cost Accounting Standard 414 - Cost of Money as an Element of the Cost of Facilities Capital; and DPC 76-3

Background

Cost Accounting Standard 414 establishes criteria for the measurement and allocation of the cost of capital committed to facilities as an element of contract cost. ASPR 3-1300, (Item II, DPC 76-3), extends the CAS 414 procedures to all contracts negotiated on the basis of cost analysis; ASPR 15-105.50 makes the cost of money, when computed in accordance with CAS 414, an allowable contract cost. The effective date of this Standard and the provisions of DPC 76-3 is October 1, 1976. Contractors and subcontractors must follow the requirements of both regulations on all CAS contracts and subcontracts which are negotiated on or after this date.

In accordance with section 414.70 of the Standard, it does not apply if either the contract award date or the date of final agreement on price as shown on the certificate of current cost or pricing data precedes October 1, 1976. However, DPC 76-3 as modified by the memorandum of September 17, 1976, may apply the techniques of CAS 414 to contracts that existed prior to October 1, 1976. In these cases, the techniques may be applied to contract modifications which price contract line items not previously priced, provided such work is performed after October 1, 1976. This includes repricing actions under type A price redeterminations. It should be noted that use of the 414 techniques for these modifications requires mutual agreement of the parties and thus is appropriate only when consideration flows to both parties as a result of the use of the technique.

The cost of money is an imputed cost which is identified with the total facilities capital associated with each indirect cost pool, and is allocated to contracts over the same base used to allocate the other expenses included in the cost pool. In other words, the cost of money may be considered to be an indirect expense associated with an individual cost pool but separately identified. Like all indirect expenses, the cost of money is subject to all the same allocation procedures as any other expense which is allocable to the selected allocation base, and each element of such base, whether allowable or unallowable, should bear its prorata share of the cost money.

The CAS 414 techniques must be used to compute the cost of money in connection with individual price proposals, forward-pricing rate agreements, and with the establishment of final overhead rates.

Facilities capital included in the cost of money computation includes tangible and intangible capital assets that generate allowable depreciation or amortization as well as land which is integral to the regular operation of the business unit, and leased property for which constructive costs of ownership are allowed in lieu of rental costs under Government procurement regulations. The treatment of leased property under CAS 414 is not addressed in this interim guidance paper. This subject will be discussed in a subsequent paper.

CAS 414 and ASPR 15-205.50 do not apply to facilities where compensation for the use of the facilities is based on use rates or allowances in accordance with Federal regulation. Also, CAS 414 provides that to be included in the base for the cost of money calculation, the asset must be used in the regular business activity, and ASPR 15-205.50 (a) states the base for cost of money is facilities capital employed in support of defense contracts. These latter criteria serve to eliminate items such as the following from the cost of money computation:

1. Land held for speculation or expansion.
2. Facilities or facility capacity which have been determined to be excess or idle in accordance with ASPR 15-205.12.
3. Assets which are under construction or have not yet been put into service.

Application of Cost of Money to IR&D and B&P Expense

A. Discussion:

Questions have arisen concerning the application of cost of money to IR&D and B&P projects.

To be decided are:

1. Is the cost of money to be considered part of or allocable to, the ceiling?
2. Is the cost of money associated with over ceiling IR&D and B&P expense to be allowable?

3. Is the cost of money associated with G&A expense allocable to IR&D and B&P expense?

ASPR 15-205.3 and 15-205.35 govern the composition, allocation, and allowability of IR&D and B&P costs. More specifically, ASPR 15-205.3(b) and 15-205.35(b) state that "Both direct and indirect costs shall be determined on the same basis as if the IR&D (or B&P) project were under contract." It, therefore, follows that the cost of money is allocable to IR&D and B&P projects and should be allocated to final cost objectives in the same manner as the IR&D and B&P expense.

A question has been raised as to whether the cost of money should be included in the total ceilings negotiated for IR&D and B&P. If this is done, the ceilings would not be comparable to previous ceilings which did not include these costs, and it would be necessary to increase the ceiling by the amount of the cost of money applicable if the same level of IR&D/B&P effort is to be supported.

Another factor bearing on this issue is the fact that the CAS Board is currently developing new cost Accounting Standards for IR&D and B&P. These Standards are expected to require changes in the method of accounting for IR&D/B&P expenses. This change, following close behind the CAS 414 change, would require two successive revisions in the method of accounting for IR&D/B&P. Under the circumstances it appears appropriate to continue the present method of establishing IR&D/B&P ceilings (excluding cost of money) and incorporate the effect of both the cost of money and the new Standards on IR&D and B&P at the time the effect of the IR&D/B&P Standards are known. To accommodate CAS 414 during this interim period, it will be necessary to obtain agreement with the contractor that while the cost of money is not included in the ceiling dollars, such costs are to be allocated, and the portion associated with allowable IR&D/B&P shall also be allowable. It should be noted, however, that the cost of money associated with G&A expense should be allocated as though it were G&A expense (see Interim Guidance Paper W.G. 77-11).

B. Guidance:

1. The cost of money is allocable to IR&D and B&P and the total allocable amount should be accounted for separately and not included in the established ceiling. However, there must be an understanding that:

a. The cost of money allocable to unallowable IR&D and B&P (amount over ceiling) shall be considered unallowable.

b. Cost of money allocable to the allowable IR&D and B&P shall be allocated to contracts over the same base used to allocate the IR&D and B&P expense.

2. Cost of money which is attributable to G&A expense shall be allocated using the procedures set forth in W.G. 77-11.

Revised Disclosure Statement

A. Discussion:

Under CAS 414 the regular method of computing the cost of money is preferred. The alternate method is available if the contracting parties can agree that the results of either method will be substantially the same. Although a contractor should decide which method he will use, and follow it consistently, a change from one to the other should not have a significant monetary impact and contract adjustments should not be required.

A further option that a contractor may make, for administrative ease, is to include, or exclude, the cost of money in the G&A allocation base. Once an option is selected, a change from one to the other should be considered a voluntary accounting change. The initial completion of the CMF form should serve as a baseline for the contractor's established practices for compliance with CAS 414.

It could be argued that since the CAS 414 preferred regular method requires the cost of money to be allocated by the same method as depreciation, the contractor's current disclosure statement provides adequate visibility.

Moreover, the CAS Board disclosure statement does not expressly require the disclosure of the practices used by the contractor to determine and assign the cost of money. However, the cost of money calculation is a significant accounting matter, and an adequate description of the practices involved are virtually mandatory to ensure an understanding of the accounting methods relating to this new cost element. Notwithstanding the appearance that the CAS 414 procedures are already disclosed in connection with other cost elements, there appears to be sufficient leeway in CAS 414 for contractors to use methods other than those disclosed for depreciation even under the "regular" method.

B. Guidance:

1. The contractor should be requested to revise his disclosure statement to include the procedures related to

CAS 414. This revision may be a single statement to the effect that the contractor will use the same procedures used in identifying and allocating depreciation to final cost objectives and that land will be assigned in the same manner as the facilities to which it relates. The contractor should be required to amend his disclosure statements to include the procedures to be used in determining the cost of money when the CAS 414 procedures are expected to vary from those used to measure, assign and allocate depreciation.

2. The contractor should disclose whether he will use the regular method and whether he will attempt to justify the use of the alternate method. Further, he should disclose whether he will include the cost of money in the G&A allocation base or not. Once an option is selected, a change from one to the other should be considered a voluntary change.

The following is an example of how the contractor's disclosure statement revision might be made:

4.1.0(n) ☒ Y
 4.2.0(n) ☒ Y
 4.3.0(1) ☒ Y
 4.5.0 Continuation sheet.

The cost of money is computed in accordance with the procedures set forth in CAS 414. We identify assets, calculate net book values, assign net book value to indirect cost pools and reallocate undistributed net book values to indirect cost pools by the same procedures as are used to identify and allocate depreciation to find cost objectives.

For any accounting period in which it can be demonstrated, and the ACO agrees that no substantial difference will result, we will estimate, accumulate and report by using the alternative method as described in CAS 414.

4.6.0 Continuation Sheet

The cost of money is allocated to final cost objectives over the same base unit of measure as is used to allocate the other indirect expenses included in the cost pool to which the cost of money is related.

For all accounting periods, whether the regular or alternative method is used we estimate, accumulate and report by including the cost of money in the cost input base used to allocate G&A expense to final cost objectives.

Application of CAS 414 to Price ProposalsA. Discussion:

The fundamental concept of using current, accurate, and complete data in pricing proposals applies equally to data used to compute proposed cost of money. Thus, historical or forecasted costs used in pricing cost of money in proposals must represent the best available information.

The Secretary of the Treasury determines the cost of money rate to be used in computing the cost of money factors pursuant to Public Law 92-41. The rate published in December is to be used from 1 January through 30 June; the rate published in June should be used from 1 July through 31 December.

In calculating final overhead rates, the Standard provides that the cost of money rate be the average of the rates in effect during the fiscal period. For example, the average rate for CY 1976 will be 8.625 percent computed as follows: $8.75 \text{ (Jan - Jun)} + 8.50 \text{ (Jul - Dec)} \div 2 = 8.625$ percent. For a fiscal year ending 31 January 1977, the average rate would be 8.542 percent computed as follows:

<u>Feb - Jun 76</u>	<u>Jul - Dec 76</u>	<u>Jan 77</u>	
<u>(8.75×5)</u>	<u>$+ (8.50 \times 6)$</u>	<u>$+ (7.75 \times 1)$</u>	$= 8.542 \text{ percent}$
12 Months			

The contractor is responsible for computing and supporting the cost of money factors. The auditor is responsible for reviewing the factors and the ACO is responsible for determining the validity of the factors for contract cost and pricing purposes. Where the contractor elects to omit the allocable cost of money from his proposal, such costs should be designated as unallowable, and may not be included in the profit. (The "cost of money" cost element is not to be confused with "capital employed," a separate profit consideration factor.) In addition, he is still required to compute the cost of money factors in accordance with CAS 414. The contractor's failure to make the computation should be considered a violation of a requirement of the Standard, however, in virtually all cases, the noncompliance will not result in increased cost paid by the Government.

The Standard provides that where the cost of money is to be determined on a prospective basis the cost of money rate shall be based on the latest available rate published by the

Secretary of the Treasury. Ordinarily, "based on" should be interpreted to mean "the same as." However, there may be circumstances when it would be better to use a rate other than the latest semi-annual rate. One such case would be when the average rate to be used in costing the contract is known. This situation may occur when a short term contract is negotiated and performed within the six month period (or other shorter period) after all the rates to be weighted in actual historical CMF determination are known. Another circumstance is when the historical method of estimating is used. Some models indicate that the historical method will rarely be appropriate for projection purposes and a close examination should be made before this method is accepted as a basis for negotiation. Contractors will frequently modify the historical data for projection purposes. Any such modification, such as, use of the latest available semi-annual interest rate (column 1 of CASB-CMF), should be considered a proposal made under the projected method. Such proposals are acceptable even when the contract period is expected to be less than one year.

Under the historical method, the cost of money factors (column 7 of the CASB-CMF) will be the same as used to establish final overhead rates for the contractor's latest completed cost accounting period. This method of estimating facilities capital to be employed, and the related cost of money, assumes that the relationship between the cost of money and the allocation base will yield a constant cost of money factor over the contract performance period. This assumption is comparable to the assumption contractors make when proposing indirect expenses using an unadjusted, experienced overhead rate. The assumption that a constant factor will be appropriate rests upon the three variables involved in the cost of money computation: the interest rate, the net book value of facilities capital, and the allocation base. Even minor changes in the interrelationship of any of these variables may substantially affect the cost of money factor.

The Standard requires that the latest available semi-annual interest rate be used for estimating purposes and this rate should be compared to the historical average. Known and anticipated additions and deletions of assets will require close examination to determine the affect on the factors. The effect of the annual depreciation on an unchanged level of facilities employed will reduce the net book value sufficiently to make the historical factors inappropriate. The allocation bases used in the cost of money computation should be consistent with those used in estimating overhead rates. Mere inflation could significantly change the relationship of the base to the imputed cost of money since the net book values are less subject to inflation.

Under the projected method, the cost of money factors will be based on the latest available cost of money rate and a forecast of the facilities net book value and allocation base for each cost accounting period of contract performance. This method should be used when the contractor can reasonably demonstrate that there will be major fluctuations in the levels of facilities employed or the allocation base to be experienced by the business unit during contractor performance. The interest rate which will be in effect at the conclusion of the negotiation and applied to the contractor's estimate may not be known when the audit report is written, or when the negotiation begins. Accordingly, care should be exercised to assure that the most recent interest rate published by the Secretary of the Treasury is considered.

B. Guidance:

1. If a contractor does not propose the cost of money, which would be allocable to the resultant contract, the PCO should specify in the contract terms that cost of money will not be allowable as an element of cost under the contract. In no event may the cost of money as computed in accordance with the procedures set forth in CAS 414 be included in profit.

2. When there is no increase in cost paid or to be paid as a result of a noncompliance with CAS 414, a determination of noncompliance need not be issued. The contract auditor should not be expected to issue a non-compliance report unless specifically requested by the ACO.

3. A careful review should be made before the historical method is accepted for pricing future work, because the historical method may result in a cost of money factor substantially higher than that which will actually be experienced.

4. When a new interest rate is determined prior to or during negotiations, the PCO should consider recomputing the cost of money amount before finalizing negotiations.

SUBJECT: Policy for Withdrawing Determination of Adequacy
of Disclosure Statement

Background

Defense contractors and subcontractors are required, as a condition of contracting, to disclose in writing an adequate description of their cost accounting practices. A Disclosure Statement is considered adequate if it is current, accurate and complete. There is wide confusion as to the right of Government to withdraw the determination of adequacy of disclosed practices when they are no longer considered adequate.

Discussion

Questions have been raised as to whether the ACO has a right to withdraw an adequacy determination that was previously given. Any consideration of the factors bearing on this question would indicate that he not only has a right, but a duty, to take this action if the statement is determined, at any time, to be inadequate. Failure to do so would relieve the contractor of any requirement to maintain the statement in a current, accurate and complete status after the initial determination of adequacy had been given. This would ultimately render the document completely useless.

A notice to the contractor that his Disclosure Statement is no longer considered adequate will have the effect of making the contractor ineligible to receive new contract awards. This, obviously, will disrupt and delay normal procurement processes and such action should, therefore, not be taken unless it is based on substantive issues. On the other hand, auditors and ACOs should not delay advising contractors of revisions to the Disclosure Statement that may appear necessary even though the issue may not be of such magnitude as to warrant withdrawal of the adequacy determination. It is important that issues not be accumulated over a period of time, to be raised at the time of a new contract negotiation. This will only serve to further complicate and prolong normal procurement procedures.

There is seldom a problem in determining whether a Disclosure Statement is current or accurate. There is a problem in determining whether it is complete. To be complete the statement must contain a level of detail adequate to fully discuss the accounting practices which the contractor employs. At the same time there is no need for

burdening the statement with minuscule descriptions of accounting procedures that will have no discernible effect on the flow of costs even if they are changed from time to time.

A determination that the level of detail in a Disclosure Statement is adequate, is judgmental and thus the detail should be expected to vary from contractor to contractor or even between cost centers of a particular contractor depending upon the volume or mix of business or complexity of the accounting system. As the volume increases the mix changes or accounting procedures become more complex, the Disclosure Statement would be expected to become more detailed.

Materiality appears to be the key word in determining what level of detail should be required. Thus, accounting procedures which, if changed, would not have a material effect on the flow of costs, either now or in the foreseeable future, should probably not be included in the Disclosure Statement.

Guidance

Materiality should be a major factor in deciding the level of detail required to be disclosed. A prime consideration should be whether a change in accounting procedure at the level of detail under consideration would have a material effect on the flow of costs, now or in the near future.

The level of detail needed to adequately describe the accounting practices will vary depending upon volume or mix of work in the plant or cost center, or complexity of the accounting system.

Contractors should be advised immediately when a revision to the Disclosure Statement is considered necessary.

ACO's do have authority to withdraw an adequacy determination previously given for a Disclosure Statement, but action to withdraw the determination should not be taken unless the issue is material and the contractor will not make the revision.

APPENDIX C

GAINING CONTRACTOR ACCEPTANCE*

In a letter to DoD procurement agencies, Brig. Gen. Tashjian requested increased efforts to force contractor cooperation on CAS matters:

1. Recently, requests for waivers to Cost Accounting Standards, Public Law 91-379, have been processed to this headquarters which were not adequately documented. The potential impact on high-priority programs should be recognized by field personnel, since waiver authority rests with the CAS Board. Further, the Assistant Secretary of the Air Force (I&L) has been unwilling to forward requests for waiver unless there is clear evidence that senior AF personnel have exhausted all efforts to have contractors accept the CAS Clause, or failing that, have demonstrated the cost and schedule impact if contract award cannot be made. The OSD policy memorandum on this matter is attached for your information (Atch 1).
2. In order to assist your personnel in gaining contractor acceptance of the CAS Clause, attached is a list of benefits that accrue to contractors (Atch 2).

ATTACHMENT NO. 1

The stiffening resistance of the Board toward granting of waivers is understandable in light of recent experience with a number of U.S. and foreign contractors. In these cases, contractors who have refused to accept the CAS clause have revised their position after detailed discussions with DoD and CASB staff representatives. In these discussions, the impact of CAS regulations was explored with contractors' accounting officials resulting in a conclusion, in most cases, that only minor changes to the contractors' accounting practices would be needed.

*The information contained in the appendix was extracted from "A Compendium of Cost Accounting Standards' Impact upon the Procurement Process," completed by Aerospace Industries Association of America, Incorporated (AIA), July, 1976, pp. 142-143.

In view of the above, when contractors or subcontractors refuse the CAS clause, steps should be taken to arrange a meeting with the company controller or other officials responsible for company accounting practices, and DoD personnel who are completely familiar with the requirements. CAS Board staff personnel have indicated they are available to participate in such discussions and should be utilized. Requests for their assistance should be made through cognizant Headquarters Staff Offices of the Military Departments and DSA.

If the efforts of the procurement activities are not successful and it is impracticable to obtain essential goods or services from another source because of excess costs, time constraints or for other reasons the case should be brought to the attention of the Assistant Secretary (I&L) of the Military Department or the Director, DSA, so that he can personally contact top company officials to resolve the problem. Where more than one department is affected a coordinated effort may be appropriate. If this does not succeed in obtaining company agreement to accept the CAS clause, the matter should be brought to the attention of the Assistant Secretary of Defense (I&L) so that he may assist in further efforts to solve the problem. If all of these steps are still non-productive, we shall consider use of a priority order under Title I of the Defense Production Act on the first major case brought to our attention.

ATTACHMENT NO. 2

The purpose of Cost Accounting Standards (CAS) is to achieve uniformity and consistency in cost accounting practices of defense contractors. Therefore the primary benefits accrue to the Government. However, there are some benefits that accrue to the contractors.

a. By requiring uniform and consistent cost accounting practices in the defense industry, no one contractor should have a significant advantage in pricing or costing because of his accounting system.

b. If a contractor has contracts subject to CAS, the clause allows equitable price adjustments, including upward price adjustments, whenever an existing contract becomes more expensive to perform because of implementation of changes caused by the standards. This gives a unique benefit to the contractor in repricing firm fixed price contracts, insuring that he does not have to absorb extra costs.

c. The CAS clauses reconcile cost accounting standards for Government contracts to generally accepted accounting standards regardless of the impact on Government contracts, thereby promoting a common accounting system for commercial or Government contracts.

d. Government contracting officers will be unable to influence the contractor to implement preferential accounting changes, thereby providing stability in the accounting system.

e. The requirement to reduce to writing the contractor's accounting system in a disclosure statement has resulted in better visibility as to the management of that company.

f. The implementation of CAS should result in less controversy between the contractor and the Government in accounting matters.

g. Acceptance of the CAS clause is a prerequisite to award of some contracts, and, therefore, makes the contractor eligible for award.

M.J. Tashjian, Brig. Gen.
Letter to Divisions, Centers,
SAMSO, AFETR, dated 12/16/75

APPENDIX D

DRAFT SAVINGS CLAUSES (Examples only)

D-1:

The parties agree that this contract is subject to an adjustment to bring the contract into compliance with the policy and procedures of Defense Procurement Circular (DPC) 76-3, 1 September 1976, with respect to cost of facilities capital and profit or fee. It is further agreed that such adjustment will be accomplished by _____ (date)_____.

NOTE: This clause was recommended for use in implementing DPC 76-3 by the Air Force Systems Command Procurement Support Division, Office of the Staff Judge Advocate. Usage of this exact clause as stated above is no longer authorized.

TREATMENT OF CERTAIN CONTROVERTED COSTS

D-2:

I

Maximum Adjustment*
For (state area to be adjusted)

Target Cost \$ _____
Target Fee \$ _____
Target Cost & Fee \$ _____

- a. The parties disagree as to the inclusion in the contract price(s) of controverted amounts of overhead costs, namely certain (adjustment area). Issues underlying these controversies are already in dispute in ASBCA Case (Number).
- b. To facilitate the pricing of this contract and the equitable adjustment of this contract upon resolution of the controverted costs, the parties agree:
 - (1) That, in the pricing of the contract, all of the controverted costs have been excluded, together with any associated profit or fee allowance (and ceiling allowance, if applicable), without prejudice to the Contractor's claim relative to the excluded amounts;

* Maximum adjustment as used in this clause is exclusive of interest.

- (2) That notwithstanding any other provisions of this contract, such pricing is subject to adjustment(s) based upon the final resolution(s) of the underlying controversy; and
- (3) That the above column quantifies the maximum pricing adjustment(s) that might be required upon resolution of the controversy. Such maximum pricing adjustment(s) are based on the data used at the time of the negotiation of this contractual instrument.

c. The parties shall diligently pursue the resolution of the controversy here involved and make appropriate equitable adjustments thereafter. To avoid the need for a formal Contracting Officer decision and Contractor appeal under this contract relating to those issues involved in the ASBCA Case (Number), it is agreed that the Contracting Officer's decision and the Contractor's appeal appearing in ASBCA Docket (Number) apply to and control those controverted sums in this contract, and that the decisions of the ASBCA or the Courts, as the case may be, on the issues involved in the referenced dispute shall be binding on the parties under this contract. Simple interest shall be paid to the Contractor on amounts of any price adjustments due to resolution of controverted costs pursuant to this part. Such interest shall be at the rate established by the Secretary of Treasury pursuant to Public Law 92-41; 85 Stat 97 for the Renegotiation Board and shall be applied to the aforementioned price adjustments, from the date these costs would have been payable by the Government had such amounts not previously been excluded from the contract, to the date of (I) a final judgment, relative to the controverted costs, by a Court of competent jurisdiction, or (II) mailing to the contractor of a Supplemental Agreement for execution either confirming completed negotiations between the parties, or carrying out a decision of a Board of Contract Appeals, relative to these controverted costs.**

** This clause was used when a contractor had already disputed a case to ASBCA.

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